FUTURE FUNDING FOR CONRAIL

HEARING

BEFORE THE

SUBCOMMITTEE ON
TRANSPORTATION AND COMMERCE

OF THE

COMMITTEE ON
INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

THE FUTURE FUNDING NEEDS OF CONRAIL AS WE ATTEMPT TO ENSURE EFFICIENT AND RELIABLE FREIGHT SERVICE IN THE NORTHEAST

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FUTURE FUNDING FOR CONRAIL

TUESDAY, APRIL 1, 1980

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 2123, Rayburn House Office Building, Hon. James J. Florio, chairman, presiding.

Mr. FLORIO. The subcommittee will come to order. I would like to welcome you today to a hearing to explore the future funding needs of Conrail as we attempt to insure efficient and reliable freight service in the Northeast. As I am sure we all know, Conrail was created in 1976 with the intention that it would become a profitable corporation. To assist Conrail in rehabilitating its plant and improving its operations, Congress has authorized a total of some $3.3 billion since 1976. At the end of 1979 Conrail had $645 million of this remaining and the U.S. Railway Association found that Conrail would not become self sustaining within the currently authorized funding level.

The General Accounting Office will testify today about Conrail's capital program for the next several years. I am concerned that we do all in our power to insure that rail service is available in the Northeast. If capital improvements are advisable then we should consider seriously how to insure that such improvements will be made.

You have seen recently in the bankruptcies of the Rock Island and Milwaukee the absolute necessity for planning for the future. Conrail may well survive in its present form, but if Conrail cannot survive and it is without future funding, we must begin to plan so that a feasible program will be available to provide transportation needs in the Northeast.

We have a very long list of distinguished witnesses. I am going to ask if Mr. Madigan, our ranking minority member, has any comments.

Mr. MADIGAN. Mr. Chairman, I understand you have another meeting. I have another meeting following your meeting. I think the most profitable thing to do would be to go ahead with the witnesses.

Mr. FLORIO. Congressman Dodd is scheduled to be our first witness but was unavoidably detained and he will be here at a later time.

I would like to call Mr. Baltas E. Birkle, Deputy Director of the Community and Economic Development Division of the General Accounting Office.

Mr. Birkle, welcome to the committee, for the record we would appreciate your introducing your colleagues.

STATEMENT OF BALTAS E. BIRKLE, DEPUTY DIRECTOR, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY HERBERT McLURE, ASSOCIATE DIRECTOR, AND FRANK KOMYKOSKI, PHILADELPHIA REGIONAL OFFICE

Mr. BIRKLE. Mr. Chairman and members of the subcommittee, we are here today to discuss our review of Conrail's operational and financial projections for 1980 through 1984 and the risks inherent in its strategy for limiting its use of Federal funding.

With me at the witness table are Mr. Herbert McLure, Associate Director in charge of our audit work at the Department of Transportation and Mr. Frank Komykoski, our team leader on Conrail work in our Philadelphia regional office.

Conrail began operations on April 1, 1976, with a Federal Commitment of $2.1 billion to cover early operating losses and to support rehabilitation and improvement projects. However, Conrail's first few years of operation showed that more Federal funding would be needed, and in 1978 Congress authorized an additional $1.2 billion bringing the total available Federal commitment to $3.3 billion. In its 1979 planning process, Conrail faced the fact that authorized Federal funding would run out in 1981 if it maintained its existing rate of spending, and had to choose between conserving the Federal funding by cutting back its capital spending for improvements, rehabilitation, and maintenance, or requesting additional Federal funding.

CONRAIL'S PLANNING PREMISES

On March 15, 1979, Conrail submitted a 5-year business plan to the U.S. Railway Association which projected a cumulative Federal funding need of $4.082 billion through 1983; $782 million more than the $3.3 billion authorized by Congress. The March plan assumed there would be little regulatory change during the 5 years and Conrail planned to spend $1.936 billion for track rehabilitation and $728 million for additions and improvements.

Less than 5 months later on August 1, 1979, Conrail modified its plans mainly by assuming that regulatory changes would be achieved early in the 5-year period. Also in order to stay within the authorized Federal funding Conrail reduced its capital spending program for track rehabilitation and additions and improvements in 1980 and 1981 by about $379 million. Conrail believed that estimated traffic levels and prices under a changed regulatory environment would provide sufficient revenues to allow the capital program to be restored in 1982.

To improve its operations Conrail has been committed to a massive track rehabilitation program. Since it was created Conrail has laid about 3,800 miles of rail and installed about 16 million ties, a program designed to prevent further deterioration and reduce deferred maintenance. In March 1979 when Conrail planned to sustain its capital spending programs it expected to lay 876 miles of track and 3.2 million ties annually during 1980 to 1983.

In its August plan Conrail cut back its programs for 1980 and 1981 to 240 miles of rail and an average of 1.4 million ties for the 2 years. Conrail's records show that to maintain its existing track condition it would need to replace about 725 miles of rail and 2.8 million ties annually.

In its August plan Conrail projected that it would be able to increase its spending on capital resources in 1982 and 1983 but that the net cutback during 1980 to 1983 relative to its March plan would still be 1,576 miles of rail and 4 million tie replacements. Conrail intends to soften the impact of the rail and tie program cutbacks by increasing expenditures for other kinds of maintenance such as surfacing.

The additions and improvements program particularly for yards and terminals holds great potential for operating improvements and better productivity. On October 6, 1978 we released a report entitled "Conrail Faces Continuing Problems" emphasizing that yard and terminal rehabilitation and modernization projects were critical and that these programs were falling far short of goals. We concluded that upgrading yards and terminals was important to expediting freight car handling and improving customer service, both crucial to Conrail's long term viability.

During 1978 Conrail attributed its slow starting yard and terminal program to problems associated with organizing a large capital program and overcoming inertia as well as management's decision to spend more time on analysis to assure moneys were spent wisely. Toward the end of 1978 we felt the program was beginning to show some vitality and Conrail nearly met its program expenditure goal for the first time in 1979.

Conrail's August plan proposed a $90 million additions and improvements program for 1980, a 36-percent reduction from its March plan and considerably less than it should be investing. Conrail estimates that a more appropriate level would be about $123 million. The U.S. Railway Association staff estimates Conrail should be spending from $130 million to $150 million for additions and improvements. As with the track programs Conrail planned to increase additions and improvements expenditures in 1982 and 1983 to offset the reductions.

We believe that curtailing capital programs in 1980 and 1981 to stay within the current $3.3 billion Federal funding creates an unacceptable risk. Reduced capital investments could result in plant deterioration and a return to declining service quality thereby eroding the benefits gained from the already significant Federal investment. Conrail assumed in its plans that regulatory reform would enable it to make pricing and plant rationalization changes that would produce revenues it could use to rejuvenate its capital programs. Regulatory reform may not allow the freedoms Conrail anticipated. Revised Conrail estimates for reduced traffic and net income in 1980 cause us to doubt whether Conrail can generate sufficient revenue to support increased investment programs in 1982.

Because of its concern over the capital deferments issue and the uncertain status of regulatory reform the U.S. Railway Association requested Conrail to submit alternative budgets and plans reflecting capital programs at more appropriate spending levels. Conrail then estimated that if there is no Federal regulatory reform an additional $587 million in Federal funding would be needed in 1981 to finance capital programs at more appropriate levels and to cover higher projected operating losses in 1980 and 1981. For these 2 years capital investment in track and additions and improvements would be increased by $326 million. Conrail estimates it could carry out the higher capital program in 1980 with authorized funding but that Federal funding would be exhausted by the year end.

Our conclusion that Conrail's capital spending plans are unacceptably risky is based on Conrail's technical judgment about the spending levels needed to prevent its track system from deteriorating and our uncertainty about the outcome of regulatory reform. In its August plan Conrail said that during 1980 and 1981 it will spend considerably less on track rehabilitation and additions and improvements than would be appropriate to system size and volume. It said that these program cutbacks will result in efficiencies associated with asset improvement. Conrail intends to have higher than normal spending in 1982 and future years and it expects to pay for the catch up costs with increased revenues that will be made possible by regulatory reform.

We think the logic of the situation argues for continued capital spending at least at the level needed to keep the system in its current condition. This is not a technical judgment but instead was reasoned out as follows. If Conrail follows its current plan and defers capital spending two things could happen; it might be able to increase its revenues enough to provide the funds needed to rejuvenate its rehabilitation and maintenance programs or it could continue to lose money and would either have to seek additional funding from the Government or continue deferring its capital programs.

On the other hand if Conrail continued capital spending at the level needed to maintain the system in its current condition it would require additional Federal funding in 1982. If it is able to increase revenues enough to provide funds for capital programs the need for additional Federal funding would be minimized because catch up maintenance and rehabilitation would not be needed and Conrail would be able to pay for its own capital programs sooner. Even if Conrail continued to lose money the need for additional Federal funding would still be minimized because catch up maintenance would not be needed.

In our March 10 report we suggested that the Congress has several options for responding to Conrail's situation. These options are not mutually exclusive and the optimum response may very well be some combination of two or more options.

The Congress can defer any action, pledge additional funds, enact regulatory reforms, or seek an alternative solution to rail problems in the Northeast.

We are not recommending that the Congress direct Conrail to maintain appropriate capital spending programs and pledge additional support if needed only because we recognize the need to constrain Federal outlays and that the Congress must choose between this and many other possible uses for scarce Federal funds. As we stated in our report the preponderance of our work relating to the railroad industry suggests that substantial regulatory reforms are needed. We are not endorsing a particular approach to regulatory reform but encourage a resolution of the matter as soon as practicable.

Conrail disagrees with our conclusion that reduced capital spending creates an unacceptable risk. It believes regulatory reform and operational improvements will permit rejuvenation of capital spending before any serious deterioration occurs.

The Department of Transportation also disagrees with our conclusion that a 2-year reduction in capital spending would create an unacceptable risk to the Federal investment and Conrail's future profitability.

It noted that Conrail and the U.S. Railway Association agree that reducing maintenance programs for 2 years will not cause serious problems if catchup funds are available at the end of that period. We agree that a short term reduction in capital programs may not be critical but think that reduced capital spending beyond 2 years could risk a return to an inadequate rail freight system in the Northeast.

This concludes the prepared statement, Mr. Chairman.

Mr. FLORIO. Mr. Madigan?

Mr. MADIGAN. Mr. Birkle, I suppose the question I would like to ask or what I would like for you to expand upon is where you delineate the various courses of action you think are available to Congress. One of those is to "seek an alternative solution to rail problems in the Northeast."

Exactly what does that mean or what do you intend for that to mean?

Mr. BIRKLE. I would like Mr. McLure to address that.

Mr. McLURE. There have been a number of proposals as to how various changes can be made to the present situation. We have not analyzed those proposals. I cannot tell you definitively whether they or any other solutions would be best.

The body of work we have developed on Conrail has generally shown that Conrail is progressing toward profitability although more slowly than originally anticipated. Whether substantial changes are needed really depends, I think, on what happens over the next few years and what effects regulatory reform would have on Conrail's business.

As we state in our report we think regulatory reform is needed and could have a salutary effect not only on Conrail but on the entire industry.

Mr. MADIGAN. The alternative solution, I assume what that means is the breaking up of Conrail? Is that the proposal you are talking about?

Mr. McLURE. That is one proposal. We are not necessarily talking about any of the particular proposals.

Mr. MADIGAN. What other proposals are there? I am not familiar with them.

Mr. McLURE. There are proposals to trim Conrail's system substantially but leave the corporation intact. There are proposals to allow other railroads to bid for and obtain certain parts of Conrail. There have been proposals to break Conrail up into operating pieces although I think by now most of those proposals have been discounted.

Mr. MADIGAN. Has your office looked at the impact on the Government considering the Government's responsibility to the Penn Central creditors, what the impact on the Government would be if the Government chose to encourage one of those alternative solutions?

Mr. McLURE. We have not analyzed that.

Mr. MADIGAN. Thank you, Mr. Chairman.

Mr. FLORIO. Mr. Lee?

Mr. LEE. Thank you, Mr. Chairman.

Mr. Birkle, the first question I would ask is, "Did you show the courtesy to Conrail in the formulation and development of this report so they had the opportunity to sign off? Did they concur with the report you submitted to us?"

Mr. BIRKLE. We met with Conrail and showed them the draft of the report and discussed the findings. We thought we had their agreement on our findings and conclusions. There was a misunderstanding unfortunately about that.

We have since issued an errata sheet and sent it to the people who have received the report to show Conrail and USRA do not agree with our conclusions. I think basically they agree with the facts in the report but there was a misunderstanding about the report conclusions.

It is unfortunate that happened. We hope it does not have an adverse effect on our relationships with Conrail which have been very good. We will still be continuing to do audit work at Conrail. We certainly hope this misunderstanding does not hurt that work.

Mr. LEE. Sir, I have had the opportunity to look at your report in some detail and I tried to keep some notes as I went through the detailed reading of the GAO report. I would like to ask you to bear with me as I attempt to articulate some understanding or misunderstandings as far as your report is concerned.

I think there is an apparent contradiction in your report as I read it. Let me quote from the covering letter accompanying the report. "We believe curtailing track programs and additions and improvements to the physical plant for 1980 and 1981 would pose an unacceptable risk to the Federal investment and Conrail."

Later on in the report GAO states, "If Conrail defers maintenance on its system and regulatory reform permits it to rejuvenate its capital spending programs in 1982 Conrail probably can live with the $3.3 billion already authorized."

As I look at those two quotations I see a distinct contradiction. Which side should I come down on?

Mr. BIRKLE. We come down on the unacceptable risk side; even though they could live 2 years or get by for 2 years we think it is an unacceptable risk because there is no real assurance they will have the money at the end of that time to rejuvenate the track; the money they hope to get through regulatory reform.

We do not think there is a need to take that kind of a risk. Even though they could tighten their belt and get by we still feel it is an unacceptable risk.

Mr. LEE. Sir, where is the risk precisely? Is it in the deregulation facet or in the current management?

Mr. BIRKLE. It is probably a combination. If deregulation does not go through in the form Conrail anticipates or hopes for that would be one type of fund reduction. Their forecast of profit and operating expenses which they came out with after the August plan indicated a little bit darker picture, so there would be less funds in that respect.

Mr. LEE. Are you aware that the current revenue picture as I understand it for Conrail is approximately 20 percent off from the USRA projections of 1975 given the fact steel and auto transportation or shipping is down substantially. That would have a direct bearing on the situation to say the least.

Would you agree?

Mr. BIRKLE. Yes.

Mr. LEE. Continuing on with some of the notes I kept in reading your report, Mr. Birkle, and again trying to understand precisely what it is you are suggesting in your report, I think the very pertinent question my distinguished colleague from Illinois put, are you advocating we do nothing; that Conrail sell off; advocating deregulation; advocating Congress appropriate more money?

Those seem to be the four options that I see. Which of those four or other options are you advocating?

Mr. BIRKLE. Initially, when we sent the draft to Conrail for comment, we were recommending more funding. Since then we have heard President Carter's speech about budget reductions. We know there are a lot of priorities for money in many programs throughout the Government. We did not feel it was quite appropriate for us to say to the Congress that they should appropriate more money for Conrail.

I think it is something they have to decide based on the priorities they have for the funds available.

We can fall back and say there should be some regulatory reform and that would help. We have been advocating that for some time.

While we did not come down and say there should be more funding, we point out without this additional money, either through regulatory reform or through appropriations, it is, in our opinion, an unacceptable risk over the next 2 years that Conrail will be able to keep up their track and other capital programs.

Mr. LEE. Mr. Birkle, does that not leave Conrail sort of in the dark? Their management plan which delineated the use of the $3.3 billion as I understand it is quite explicit.

Is it not the responsibility of the Congress and the administration to set the policy in what direction we want our rail network to go? Are we not being somewhat irresponsible by not suggesting or recommending what direction we want them to go, either give them more money or say you should deregulate.

Should we not set the policy?

Mr. BIRKLE. I think so.

Mr. LEE. What are you recommending as far as a policy is concerned? I would think that would be a major objective of the report.

Mr. BIRKLE. Deregulation. We have supported that all along. I think another possible approach would be the legislative committee could authorize additional funding if needed. In other words maybe not appropriate it right away but at least authorize additional funding in case the climate does not change to the point where

Conrail has their own funds to do the capital rejuvenation they want to do starting in 1982.

Mr. LEE. Mr. Birkle, what is "deregulation" by your definition?

Mr. BIRKLE. There are many different forms it could take. Maybe it would be better if I asked my colleagues to answer.

Mr. McLURE. As you know it embodies many different things. As we point out in our report regulatory reform could range from giving the Interstate Commerce Commission more freedom to continue administrative reforms they have made, or on the other extreme, pulling back completely and saying railroads can compete in the free enterprise system without any fetters at all.

There are several proposals on the Hill now. We generally agree with the House proposal and the Senate proposal although, as in any proposal, there are things we think are better than others. We are not endorsing any particular approach at this point and would want to note what ICC has done has made considerable improvement and particularly Conrail's freedom in the pricing area.

Mr. LEE. Would it be safe to conclude that what you are really saying is you are endorsing the concept of deregulation without a precise definition as to what "deregulation" is which would be somewhat similar to the overall report; you are covering a lot of turf but not really coming down with explicit recommendations as to what direction the policy should take?

Mr. McLURE. I think that is a fair characterization.

Mr. LEE. Mr. Chairman, I yield back my time, sir.

Mr. FLORIO. Thank you.

All of your calculations with regard to the impact of deferred maintenance and capital spending were done with the present configuration of Conrail? Did you work out any alternative scenarios?

Mr. McLURE. No.

Mr. FLORIO. You did everything in line with the present configuration?

Mr. McLURE. Yes.

Mr. FLORIO. Which aspect of regulatory reform do you see being of the most assistance to Conrail in resolving this particular problem we have of capital expenditures? You seem to hold out in your report that is one of the main benefits that is going to be of assistance to Conrail.

Which part of regulatory reform do you see as most important to resolving this problem?

Mr. McLURE. Mainly freedom to set their prices at least within a certain range as they see fit and the freedom to adjust their system according to the traffic levels that occur as a result of their pricing.

Mr. FLORIO. "Adjust their system," meaning what?

Mr. McLURE. Limit service over certain portions of the system or in fact abandon parts of the system.

Mr. FLORIO. Do you see there is a need to modify or shrink the overall system?

Mr. McLURE. Conrail and the U.S. Railway Association think there is.

Mr. FLORIO. What do you think?

Mr. McLURE. I personally think pricing adjustments will result in a need for Conrail to change the levels of service over parts of their system and let parts of their system go. Those parts of the system would not disappear necessarily. The railroad and the U.S. Railway Association speak in terms of rationalization which is a process of making rights of way and rail line itself available to State or local authorities or private industry if they wish to continue service over those portions of the system.

That is another reason we feel continued maintenance would be useful because there are Federal programs to contribute to State and local authorities taking over parts of the system. If Conrail does need from its own perspective to limit service over portions of the system then continued maintenance it seems to us would lessen the impact on Federal assistance for State and local authorities.

Mr. FLORIO. Do we think it is an appropriate use of Federal dollars to continue to maintain, and perhaps even upgrade, lines that will be affected by deregulation to provide the Conrail system with the ability to unload them to someone else such as a private carrier or States or communities?

Mr. MCLURE. That is an appropriate question.

Mr. FLORIO. Can we assume that in the deferral process, which apparently is going to take place, that Conrail will use its best judgment as to where it can use its limited resources so as to achieve the end goal—having a viable for profit system?

Mr. MCLURE. Our understanding is to date Conrail has not spent any extensive Federal money or its own money in rehabilitating other than the main portions of its system; those portions of its systems that carry most of the freight and would be continued in service. We would strongly object if they had spent their money in other places.

It seems to us what we are talking about is not curtailing maintenance on the bulk of the system but curtailing on important parts of the system. They have estimated they would abandon under the largest abandonment suspicions they have about one-fifth of the system and maybe a bit more.

They have reduced in their August plan their expected capital expenditures considerably more than that which indicates to us they probably are not intending those reductions to go on the portions of the system where they think it will limit service. They are talking about more important parts of the system.

Mr. FLORIO. You are anticipating 2-year deferrals will be over the main portion of the line?

Mr. MCLURE. We think substantial parts of it will have to be.

Mr. FLORIO. When you used the term "unacceptable risk" I got the impression from your testimony that the unacceptable risk aspect is something other than if deregulation takes place; traffic; and weather which there is no control over. Are not talking about risk in the sense of the plant physically falling apart as a result of the 2 year deferral?

Mr. BIRKLE. Not in 2 years completely falling apart. It would be a step toward that if rejuvenation did not take place and increased capital spending did not take place at the end of the 2 years.

Mr. FLORIO. Is that not always the case? If we can foresee that at some point there will not be sufficient revenues to maintain the plant, would there always be an unacceptable risk that the absence of an appropriate amount of money would result in an ultimate deterioration?

Mr. BIRKLE. I think it is a needless risk because if maintenance is continued at normal levels and regulatory reform or whatever other management improvements Conrail makes results in profitability in 1981 or 1982 then they will not have to catch up on the maintenance they have deferred and the total investment will be minimized.

Mr. FLORIO. What was the basis of your figure of $587 million to cover the capital program? I assume that is what you regard as the shortfall that would be needed to continue maintenance under the current plan?

Mr. MCLURE. That is Conrail's figure that they gave to the United States Railway Association as part of an alternate plan. USRA asked them to estimate what it would cost for them to maintain normal maintenance programs and the possible problems associated with not getting regulatory reforms.

That is sort of a maximum possible.

Mr. FLORIO. It is your understanding Conrail's position is that, although they would like to have that $587 million, the absence of the $587 million in their opinion would not constitute an unacceptable risk such that by deferring maintenance we could adjust to that loss?

Mr. MCLURE. I am certain they are prepared to talk about that. That is our understanding of their position.

Mr. FLORIO. Thank you very much. Mr. Madigan?

Mr. MADIGAN. I would like very much if you gentlemen would submit to the subcommittee the number of requests for various kinds of investigations that the General Accounting Office has received from Members of the House and Senate during the past fiscal year compared to the number received during the previous fiscal year; the staff levels in the General Accounting Office for both of those years and the total authorization for both of those years. I thank you very much.

[The following information was received for the record:]

GAO RESPONSE TO MR. MADIGAN'S QUESTION

In fiscal year 1979, GAO operating divisions received 785 requests for audits and evaluations from committees and 723 requests from Members. We also responded to 834 Member requests concerning claims by and against the U.S. Government involving Government contracts, employee pay and allowances, or travel and transportation.

In fiscal year 1978, GAO operating divisions received 776 requests from committees for audits and evaluations and 706 requests from Members. We also responded to 573 Member requests concerning claims by and against the U.S. Government involving such subjects as Government contracts, employee pay and allowances, and travel and transportation.

GAO STAFF LEVELS

	Professional	Other	Total
Employees on rolls at Oct. 1, 1978	4,166	1,064	5,230
Employees on rolls at Sept. 30, 1979	4,067	1,007	5,074

The fiscal year 1979 appropriation for GAO was $185.9 million of which $2.0 million was not available for obligation by provision of Public Law 95-391.

The fiscal year 1978 appropriation for operating GAO was $176 million.

Mr. Lee?

Mr. LEE. Thank you, Mr. Chairman.

Again from the notes that I kept from your report, if you had been told by Congress as Conrail was in 1978 that $3.3 billion was going to be the extent of the funds to be allocated for their management and for fulfilling their goals and objectives and the administration's budget which does not propose any additional funds for 1981, what would you do differently than what Conrail is currently doing to protect this investment?

Mr. BIRKLE. It is hard for me to say what I would do in their position. I can see the merits of their position. It is just that time has changed between 1978 and today. Because Congress chose to appropriate $3.3 billion does not necessarily mean they would not be willing to give more money if they needed to protect their original investment.

As we point out in the report, with the substantial investment that has been made by the Federal Government, do we want to take the risk of losing the benefit of that by not appropriating a little bit more to keep the system in a good state of repair?

Mr. LEE. You are suggesting that more money should be appropriated to protect the investment?

Mr. BIRKLE. We did not make that recommendation.

Mr. LEE. I am aware of that, sir. I hear you saying something different than what your report says.

Mr. BIRKLE. I think it is up to the Congress to decide whether or not they should appropriate more.

Mr. LEE. I think in the end that what you are saying in this report is you are recommending Conrail be forced to spend more money at least as I read the report and I think with all due respect to the report you submitted that I would like to characterize this report possibly as the Trojan Horse.

It seems on the one hand you are flagellating the Conrail Corporation for reducing its program but then you seem to be unwilling to say they should be forced to spend more money or should be given more money to protect the investment you were attempting to evaluate and analyze in your report.

I think the report if I may say so, seems to fall far short of the explicit recommendations that I think this committee would like to see and I am sure our colleagues in Congress would like to be advised, particularly as one member who has a lot to lose in the Northeast if we do not protect the investment we have made and expand the service which is so critical in the northeastern part of the country.

I do not know whether you agree with that assessment; you probably do not. It falls far short in my judgment of the explicit recommendations that I think we were looking for.

Mr. BIRKLE. An explicit recommendation would depend on the extent to which regulatory reform is enacted. You would not need to appropriate as much or any if the regulatory reform is enacted in the form Conrail would like to have and would enable them to earn more money.

There are other factors involved. We cannot sit here and say Congress should appropriate more money until we really know what is going to happen on regulatory reform. That could be one of the reasons why we backed off on the recommendation we had in the draft.

Mr. LEE. Your colleague was speaking to the point of deregulation and possibly that is the remedy that could help with this situation.

Mr. BIRKLE. That is correct.

Mr. LEE. Thank you, Mr. Birkle. Mr. Chairman, I yield back my time. Thank you very much.

Mr. MADIGAN. Thank you, Mr. Lee. Gentlemen, thank you very much for coming this morning.

Our next witness was to be Congressman Dodd. He has not yet arrived. We will proceed with John Sullivan, Administrator of the Federal Railroad Administration who is accompanied by Mr. Gallamore and others.

STATEMENT OF JOHN M. SULLIVAN, ADMINISTRATOR FEDERAL RAILROAD ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR, STEVEN R. DITMEYER, ASSOCIATE ADMINISTRATOR, POLICY AND PROGRAM DEVELOPMENT, AND TIMOTHY MURPHY, ACTING DIRECTOR, OFFICE OF NORTHEAST FREIGHT PROGRAMS

Mr. SULLIVAN. Mr. Chairman, on my right is my Deputy, Mr. Robert Gallamore. To his right is Mr. Steve Ditmeyer, my Associate Administrator for Policy and on my left is Mr. Tim Murphy who is our Acting Director of FRA's Office of Northeast Freight Programs.

Mr. Chairman, I am pleased to be able to appear before you today to present an overview of Conrail's financial prospects from the perspective of the Department of Transportation.

In calendar year 1979 Conrail had the best year in its 4-year history. It generated a net loss on the order of $180 million; half the loss it incurred in 1978. It also obtained a $200 million improvement in cash flow from operations over 1978 levels.

The Corporation expects a performance drop in calendar year 1980 due largely to unfavorable projections for the national economy and resulting traffic declines. Yet Conrail expects to improve its financial performance in calendar year 1981 as the economy progresses and traffic levels improve.

Conrail does foresee financial challenges due to the 1980 performance problem. It believes it can meet them through calendar year 1981 with a combination of initiatives; operating efficiency improvements; creative rate actions that depend on regulatory flexibility; slowdowns in track rehabilitation and plant additions and careful financial management.

Thus the Corporation has not requested a new Federal authorization in fiscal year 1981 and the administration has not budgeted any financing over the existing $3.3 billion.

For several reasons FRA considers this no funding position to be the most responsible and feasible course of action. Conrail's performance improvement between calendar years 1978 and 1979 suggests that Conrail's management is gradually succeeding in controlling operations and in achieving some productivity improvements.

Better than expected performance in the first quarter of calendar year 1980 has helped to reduce Conrail's first quarter drawdowns by about $100 million from previously budgeted levels. We trust that this Congress will pass a regulatory reform bill for the rail industry that will allow Conrail the ratemaking flexibility it needs to achieve the financial results it forecasts. The recent compromise between the Southern Railway System and Conrail on joint rates strengthens our belief in the prospects for timely regulatory reform legislation.

Despite these positive factors a forecast such as Conrail's is only as good as the assumptions on which it is built. Ultimately these assumptions may prove to be over optimistic in several aspects. The national and northeastern economies may perform more poorly than Conrail expects. The Congress may fail to legislate meaningful regulatory reform for the rail industry. The Corporation itself may fail to achieve the operating efficiencies it seeks. Under any of those circumstances Conrail could develop emergency financing requirements in fiscal year 1981.

In that event the Department would consider requesting funds to allow Conrail to complete up to its 1980 and 1981 fixed plant rehabilitation and improvement programs at their currently budgeted levels. We would present to the Congress at that time our recommendations as to the amount and funding mechanism. We would not fund any 1980 or 1981 capital programs above the currently budgeted levels. I say that because Conrail has not demonstrated that the impacts of the ongoing deferrals would be debilitating in the 1980 to 1981 period, irremediable thereafter or contrary to the long term interests of the Corporation.

Also substantial regulatory reform in 1980 and 1981 could lead to shifts in traffic volume and composition that would alter Conrail's future fixed plant needs. An augmented program in 1980 and 1981 could run counter to these prospective changes in traffic patterns.

Of course Conrail may identify a need for a new Federal authorization in fiscal year 1982 and beyond. In that eventuality we may wish to employ an approach similar to that of title V of the 4R act in which fixed plant rehabilitation and improvement funds would flow to Conrail through the Department on a project by project or group of projects basis.

We believe that Conrail eventually should be placed on an even footing with the railroad industry in applying for the limited amount of Federal funds available for railroads. We will have a better appreciation of the Corporation's prospects in fiscal year 1982 and thereafter when we receive Conrail's 5-year business plan for calendar years 1981 through 1985 this coming June.

We would appreciate swift committee consideration of the Conrail 3R act title V labor protection provisions which we recently forwarded to Congress.

Mr. Chairman, this concludes my remarks. I would be pleased to answer any questions.

Mr. MADIGAN. Thank you. Mr. Lee?

Mr. LEE. Thank you, Mr. Chairman.

Mr. Sullivan, could you expand on your recommendation under the 3R act and the labor provisions? What are you recommending?

Mr. SULLIVAN. Actually that would entail additional authorizations. It would also entail fixing the formula that the labor protection is computed on to eliminate windfall payments to individuals. I would be happy to supply for the record the full proposition.

Mr. LEE. In essence is that request asking for more money?

Mr. SULLIVAN. Yes, sir.

Mr. LEE. How much more money?

Mr. SULLIVAN. It is $235 million.

Mr. LEE. On page 3 of your testimony you indicate you would not fund any 1980 or 1981 capital expenditure or programs above the currently budgeted levels. Can you expound on that point?

Mr. SULLIVAN. I guess it comes from kind of an approach where if I am the banker for a business and the business does not ask me for money I do not want to push any in their door. I think Conrail has got ahold of a tiger. They have done very well with it. They see some bad times ahead in traffic downturns. They are sensibly stretching out their use of their capital dollars and yet they are not completely abandoning the work that needs to be done.

I think the budget that represents a decrease still represents spending $200 million on track work; $90 million on additions and improvements. In capital investments in locomotives and cars, Conrail's budget for 1980 represents an increase over 1979 levels.

I think it shows good targeting by Conrail management in a time of very severe financial conditions. I think that is good sense.

Mr. LEE. On page 2 in the second paragraph you allude to the assumptions upon which the revenue statement evidently is projected for Conrail and take into consideration the status of the national and northeastern economy situation.

Do you have any different facts than the assumptions that were made? Do you think they are valid assumptions or invalid?

Mr. SULLIVAN. I guess what we are saying is they are assumptions that are subject to variance. In other words you can assume a certain level of traffic but if business conditions are say 10 to 15 percent worse than you anticipated you will experience a negative variance.

I think I have read in a recent quote from Mr. Jordan that automobile traffic right now is off about 17 percent.

These will vary commodity by commodity but basically they are making assumptions that are subject to variance.

Mr. LEE. That was the point I was trying to make with Mr. Birkle. It is my understanding the 1980 revenue projections are off some 20 percent from what the USRA report projected back in 1975 compounded by the point that you are making with the fall off in steel shipments and auto shipments that exacerbate the current situation.

Thank you very much, Mr. Sullivan. Mr. Chairman, I yield back my time.

Mr. MADIGAN. Thank you, Mr. Lee.

Mr. Sullivan, apparently some traffic on Conrail moves at rates less than what Conrail could presently charge without going to the Interstate Commerce Commission for any type of approval of the rate increase.

Presumably traffic moves at that rate of fare because of competing modes of transportation that would take the traffic away if Conrail attempted to raise rates to a more compensatory level.

When we talk about rate deregulation being the solution to the problems of Conrail, I guess we need to understand how much of Conrail's freight is going to still move at less than compensatory rates because of competition.

I wonder if the FRA has a study of that or knows what the answer is to that question?

Mr. GALLAMORE. Let me attempt an answer, Mr. Chairman. It is entirely possible Conrail would continue to carry some traffic at less than compensatory rates because of competing modes but it would not do that for long under a deregulation approach or under the existing regulatory scheme.

Eventually the investment requirement would not be worth it and that traffic should be abandoned in some way. It is far better for them to take an aggressive approach that says let's try to get the rates up on that traffic to make it compensatory.

My point is simply that you cannot for long carry traffic that you are losing money on. I think Conrail realizes that.

Under the new regulatory scheme that we are happy to see working its way through the Congress, Conrail would have more flexibility to do that. You are right that there is traffic that is moving at less than compensatory rates. I believe it probably is true that there is traffic that Conrail could raise the rates on even under the present scheme but would not do that right now because of a short-term-cash impact it might have.

It cannot continue for long. That would be our point.

Mr. MADIGAN. Is that a large enough percentage of their business that if they eliminate that traffic by raising rates then the total financial capability of Conrail will be so reduced, that they would not be able to afford to maintain the type of overhead structure they presently have?

Mr. GALLAMORE. That certainly is a possibility and one would have to be very careful that where rate adjustments are made that corresponding adjustments in the physical plant and facilities are made.

We have gone through some of that work in our analysis with the Railway Association. This has to be done in a study context. It is not done in the real world. When we look at a line to see whether it might be a viable line, the traffic on that line is considered as to whether it is compensatory so that a whole segment of traffic or track can be considered together.

I do believe with rate adjustments we can save some lines that otherwise would be lost and while it may be painful to shippers involved on the immediate line it may be far preferable than losing the line altogether and having to shift to another mode.

Mr. MADIGAN. We hear complaints from shippers on lines where traffic originates other than Conrail but which is interlined to Conrail. They say even though transferring to another mode of transportation like truck is expensive for them, even though it costs more than it would cost to move the traffic of their products by rail, they are switching to trucks because the Conrail portion of the service is so poor that they cannot continue to depend on it.

I am talking about people in the Carolinas trying to ship furniture and people in other parts of the South trying to ship fruits and vegetables.

Do you have those kinds of complaints at the FRA?

Mr. SULLIVAN. If I may say, Mr. Chairman, they are few and far between. I do not think we would be the forum for direct complaints.

My perception is in the time they have been in the saddle Conrail has made considerable improvements on their service problems. I think the question of what commitment they should have to assets in a marginal market where a slight increase in their rate would lose traffic is a judgment that management has to make and I would hope they would make the judgment on getting adequate compensation so even if they would lose certain amounts of traffic, that would get them out of a market and let them dispose of the assets committed to that market and lower their overall cash requirements, even if they did have to slim down their overhead and management structure to accommodate themselves to the market that is really there for them.

There are definitely some service sensitive commodities that are more suited to truck delivery rather than rail delivery.

Mr. MADIGAN. I continue to be concerned about the ultimate possibility of having to go to the floor of the House of Representatives and ask for more money. We just went for another $750 million on the Northeast corridor yesterday. That brings that to $3 billion. Here is over $3 billion that has already been invested in Conrail.

It is difficult, Mr. Sullivan, to continue going to the floor of the House of Representatives and asking for more money. There does not seem to me to be adequate assurance that deregulation is going to solve the problems of Conrail if the Conrail system is too big; if the service on the Conrail system is inferior, on an interim basis it is being suggested to us that all we need to do is just defer maintenance.

Do you not think deferring the maintenance is ultimately just going to cost more? It still has to be done. It is going to have to be done probably at inflated prices.

Mr. SULLIVAN. As I understand it Conrail is targeting their maintenance in a way that they are able to make do with the suggested levels without a severe impact on their ability to delivery service without the need of creating a lot of slow orders which would be coming in if the track were really deteriorating.

I think the larger danger here is this is debt for Conrail's corporate structure and their corporate future and you get to a point where the amount of debt you are taking on may be what sinks you rather than stretching out your capital improvements a little bit.

It is a very fine judgment. I am happy to sit here and support Conrail's management in the judgment they are making because I think what we can see is they do have the ability to target these moneys and at a time like this we are happy frankly that they are not coming to you for more dollars.

Mr. MADIGAN. Of course that could just indicate a sensitivity on our part about what I am already talking about, the burden for us in trying to get the dollars.

Mr. SULLIVAN. Yes, sir.

Mr. MADIGAN. Instead of making a good management decision they might be making a political judgment and then making a management decision taking into account what the politics are up here.

You know what we did with the Rock Island yesterday on the House floor and what we have previously done with the Milwaukee. Do you think that is the ultimate solution to Conrail, to allow Conrail to be acquired by other railroad operations?

Mr. SULLIVAN. I guess what I feel in the case of the Rock Island and in the case of the Milwaukee there were major identifiable segments of those railroads that in any stretch of anyone's imagination would not become viable. I think in the case of Conrail you have a railroad that has gross revenues in the neighborhood of $4 billion covering an area where there is a tremendous amount of industrial activity. There is a tremendous amount of consumption of all sorts of products.

I am inclined to think that out of their territory can emerge a viable railroad. I do not think I have yet seen that map that draws the right segments or the right sell offs that are exactly the right answer.

What we have seen in the work we have done so far in analyzing fire wall concept of chopping off the eastern end of the railroad is essentially there is no fire wall. There are good and bad segments of the railroad in all various segments of it.

Inevitably given the regulatory climate to price their service according to what they see in a particular market and commensurably reduce their costs as necessary, I think Conrail can emerge into a viable private sector railroad. I think it is going to take some doing but I think it can be done.

Mr. MADIGAN. Under the supplemental transactions provisions of the 3R act which provides authority for restructuring rail properties, has any restructuring taken place in Conrail?

Mr. SULLIVAN. Yes, sir. Mr. Murphy can tell you the status of that right now.

Mr. MURPHY. There has been one proposal submitted under that process. It involves the transfer of two rail lines to the Providence and Worcester. That has gone through the full administrative process and is now before the special court for consideration which is the last stage in that very lengthy process.

Mr. MADIGAN. Is it possible to assign the fair market value as the net liquidation value until the valuation case is settled?

Mr. MURPHY. The evaluation that was imposed in the one proposal to date used going concern value based on Conrail's analysis that showed that the line in question was a money maker for it. That price is now being considered by the special court as to whether or not it is fair and equitable to Conrail.

We only have the one proposal and in this case an apparently profitable line and going concern value was used in that one situation.

Mr. MADIGAN. That is of the total of all the restructuring that has been done under that provision of the 3R act?

Mr. MURPHY. That is correct.

Mr. MADIGAN. Mr. Sullivan, I am sure Mr. Florio had questions which he wanted to ask you. He is obliged to be at another meeting. I do not want to delay you until he comes back. I am going to ask unanimous consent to make his questions a part of the record and ask you gentlemen if you would submit the answers in writing.

Mr. SULLIVAN. We would be happy to, Mr. Chairman.

Mr. MADIGAN. We do very much appreciate your coming down and being with us this morning. Thank you.

Congressman Dodd is still not here so we are going to proceed with Edward G. Jordan, Chairman and Chief Executive Officer, Consolidated Rail Corporation who is accompanied by Mr. Sweeney.

STATEMENT OF EDWARD G. JORDAN, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONSOLIDATED RAIL CORPORATION

Mr. JORDAN. You have stated that the purpose of this hearing is to discuss the possible need for additional Federal funding for Conrail and the alternatives available to the Government. With your indulgence I do not believe anyone can adequately discuss either or both without addressing the central question of whether the members of this committee and the entire Congress still believe that the goal of rail service in the Northeast includes a self-supporting Conrail which is part of a financially independent rail industry.

If the Congress wants to maintain existing levels and patterns of rail service with the existing rate structure and regulatory system along with a diminishing traffic base regardless of the cost to the taxpayer then the answer is yes, Conrail will need more money. For in that situation it will remain a conduit for hidden subsidies to those shippers who are not paying the full cost of the services provided and to other railroads who because of inequitable divisions receive an unfair share of overall revenue.

Likewise more Federal funds will be needed if the Government's objective is to rehabilitate every mile of track despite continuing traffic declines and inadequate rate levels for some of that traffic which taken together result in unprofitable operations.

Members of the Congress should and I think do bear in mind that an investment becomes a subsidy when it grows too large to be paid back or when additional funds simply do not earn a rate of return equal to their present costs. The investment required for continuing the existing system with no fundamental change is very likely to result in that sort of investment in our judgment.

On the other hand if Congress still wants an economically viable rail freight system in the Northeast and is willing to take the necessary action to allow that to occur, fundamental regulatory change, then the probability will be greatly diminished that Conrail will need more than the $3.3 billion in Federal money already authorized as I think both of the previous witnesses have stated as well.

Thus as a prelude to determining whether Conrail will need additional funding Congress must first clearly define its objectives with regard to Northeast rail service and the timing and scope of rail regulatory reform. I believe it would be inappropriate and imprudent for the Government to advance additional funds solely to improve physical facilities without a clear resolution of those questions. This clearly must be understood because one of the most important lessons learned so far is that the Northeast rail problem cannot be solved with money alone; fundamental structural changes in the way rail business is done in this region are the best assurance that the rail problem can be eradicated.

Conrail's objectives in its first 4 years have defined our strategy and if I may I think it most appropriate to be here today because we commence today our fifth year of operation. April 1 is the anniversary of conveyance day which is the date we started.

I would like to describe for a moment the progress we have made in that time.

Conrail's overall objective is that which the Congress specified in section 101(B) of the Regional Rail Reorganization Act of 1973. That objective is, "The reorganization of railroads in this the Northeast-Midwest region into an economically viable system capable of providing adequate and efficient rail service to the region."

In short the intent of the 3R act was to simply provide adequate rail transportation to the Northeast region but service on a financially self sustaining basis.

In our view Conrail has made significant progress. In 1979 losses were about $200 million below those of 1978. Service quality has improved dramatically. In fact in the 4 years since conveyance Conrail's losses have been reduced from more than $400 million in the first 12 months of operations to about which I would estimate $150 million in its most recent 12 months ending yesterday.

Since 1976 the most massive rehabilitation program in railroad history has been successfully undertaken. As I have noted it is now abundantly clear that more money alone will not solve the underlying impediments to economic self sufficiency.

Conrail's August 1979 business plan made that clear and laid out Conrail's strategy for managing the Government's investment to pursue the twin goals of financial viability and adequate service.

Because of its importance in considering the issue of additional Federal investment in Conrail I would like to briefly review the philosophy of that plan. It is based on two key premises and I quote, "Conrail will have available from the Federal Government the currently authorized $3.3 billion and no more." Second, "The Federal Government will reform regulation to an extent which will enable Conrail to operate within the currently authorized funding while at the same time meeting service goals."

Those premises reflect the obligation Conrail believes it has to develop its plan to function as a private enterprise with the expectation to limit the funding available to it so as to leave a reasonable chance to pay it back. Furthermore we believe we should and have identified changes in public policies which would improve the likelihood that further Federal investment in Conrail will not be required.

To continue meeting the statutory goals within the limits of available funding Conrail has stated clearly that it must make temporary reductions in its rehabilitation programs during 1980 and 1981. Nonetheless Conrail's 1980 rehabilitation programs will total approximately $476 million.

In these programs the corporate strategy is to preserve the gains already made. For example we will emphasize surfacing roadbed, a cost effective means for maintaining upgraded track and we will continue rehabilitating strategically important segments of the railroad that remain in bad shape.

In the judgment of Conrail's management and Board of Directors these reductions can be made without significantly affecting service levels because of the substantial progress Conrail has made over the past 4 years in rehabilitating its yards and terminals; upgrading its equipment fleet and restoring its track network.

I would point out for example that at the end of 1979 only about 170 miles of Conrail's 5,110 mile core route system remained subject to slow orders and few if any of those affected operations.

Indeed the 1980 program will result in a reduction of slow order miles by the end of 1980 as compared to the beginning of the year, not as has been alleged an increase. Moreover these critical yards and terminals which have been identified for rehabilitation are continuing to be fixed and recently we approved the start up of the Elkhart yard project which is the last major one to be undertaken.

While Conrail will be unable to make major additional gains in overcoming the remaining deferred maintenance during the next 2 years the progress already made mitigates the effects on operations of a reduced rehabilitation program. This is consistent with what is happening to traffic levels in the region.

In the past 3 years rail tonnage in the Northeast has continued the general downward trend of the last three decades. Although Conrail has essentially maintained its market share in comparison with other major railroads of the region the economic problems of the region and changes in its economic base continue to decrease the potential for growth.

Conrail thus is being rebuilt while the use of the rail mode in providing freight transportation is diminishing. In Conrail's case the result is a system too large for the amount of the business available to sustain it.

Conrail also has provided the Government with two contingency plans if deregulation in a meaningful way does not occur. The first contingency plan also assumes no further Federal funding will be available, Conrail's principal strategy in that event would be to substitute a major reduction in fixed plant for the pricing freedom of regulatory change as a means of achieving self sustainability without additional Federal investment.

If present regulatory constraints prohibit Conrail from either exercising more market freedom to price or from reducing its plant Conrail has proposed in that same August plan a second contingency plan based on the presumption that the Federal Government will invest additional funds.

Thus the appropriation of additional funds should occur only if regulatory reform will not produce needed financial gains or if physical plant shrinkage cannot be shown to generate sufficient savings.

I think it is important to note that Conrail has not nor does it intend to propose continuous increases in deferred maintenance.

We have assessed the implications for Northeast rail service if there were no regulatory reform, no major geographic cutbacks and no additional funding. This analysis was provided to the Government and showed clearly a plant in 5 years with substantially reduced capacity to serve its customers.

In closing I would like to repeat what has already been said in our plan. Conrail has formulated its business plan on the two key premises cited earlier because it believes that national policy is now directed toward creating an environment in which Conrail and the entire national rail industry can reach a point of true financial self sustainability.

Without doubt the status quo, continuation of the present regulatory framework and the consequent insulation of the rail industry from the real dynamics of the marketplace could be continued. Clearly the financial consequences of that course are certain; a continuing and increasing need for substantial Federal subsidy to perpetuate a Northeast rail system that carries too much unprofitable traffic on too much trackage.

Adoption of such a course of action in my judgment is essentially an admission that there will not be a private sector solution not just for Conrail but ultimately for the bulk of the Nation's railroads which on the whole also believes that reduced regulation is a requirement to survival.

The plan proposed by Conrail emphasizes the opportunity for Conrail to achieve financial self sustainability by freeing it and the rest of the rail industry from archaic regulatory restraints thereby minimizing further Federal investment in Conrail and providing an opportunity for a private sector solution.

Mr. Chairman, the real issue we are discussing today goes beyond the possible need for additional funding for Conrail, to whether Congress wants a financially self sustaining rail freight system in the Northeast and whether it wants to avoid future crises in other parts of the industry. If so fundamental regulatory reform appears to be the best means for achieving those goals. If not the Nation will pay through subsidies to the rail industry and the social cost of meeting other public policy objectives.

In any case it is the members of this committee and the entire Congress who must decide how the Nation will pay for the rail service it needs or chooses to have and not whether for the services are not and nor will they be free.

In this regard I would like to submit for the record Conrail's annual report for 1979 which elaborates on the progress achieved by Conrail and on the public policy choices which now lie ahead.

I am available for your questions, sir.

[Testimony resumes on p. 57.]

[Attachments to Mr. Jordan's prepared statement follow:]

MAJOR EXPENDITURES & EQUIPMENT FINANCING

1976-1979 Actual/Current 1980 Budget

($ MILLIONS)

Major Expenditures	1976	1977	1978	1979	1976-1979 Total	1980 Current Budget
Discretionary Track	$234	$292	$332	$372	$1,230	$200
A&I	43	90	125	144	402	90
Major repairs to Freight Cars & Locomotives	83	160	197	136	576	106
Conversions and Rebuilds of Equipment	21	19	49	63	152	80
TOTAL	$381	$561	$703	$715	$2,360	$476

	1976	1977	1978	1979	1976-1979 Total	1980 Current Budget
External Financing for New Equipment Acquisitions	$7	$189	$341	$293	$830	$372

A rail freight system that's back on the track

Consolidated Rail Corporation
Annual Report 1979

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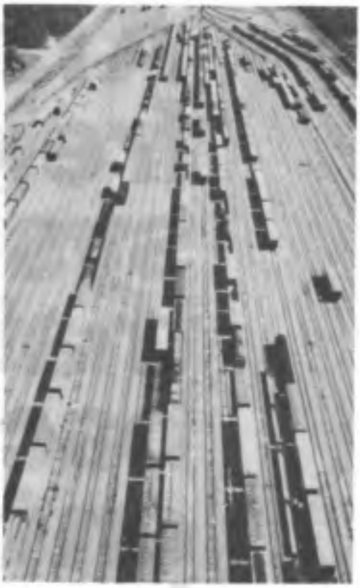
Photo at right: Conrail's DeWitt Yard near Syracuse, N.Y.



Conrail is a rail freight system that's back on the track, moving toward financial self-sustainability. Yet, substantial obstacles remain which will affect the track ahead.

Message from the chairman and the president

On behalf of the Board of Directors, the management, and the employees of Conrail, we are pleased to report that Conrail in 1979 made substantial progress, upgrading the level of service provided to its shippers and continuing the trend of improving financial performance, which began in mid-1978.

In 1979 the Corporation reported a loss of $178.2 million. In 1978, Conrail's loss totaled $385.4 million. The reduced loss in 1979 was encouraging in view of the relatively less favorable economic conditions that prevailed for rail business in the Northeast, particularly during the last six months of the year. Consolidated revenue for 1979 was $3.958 billion, compared with revenue of $3.510 billion in 1978. Tonnage in 1979 was up 2.0 percent over the previous year, while net revenue ton-miles were essentially stable, increasing 0.2 percent.

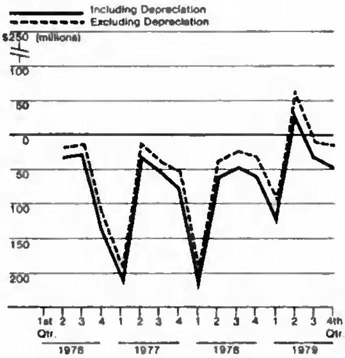
During 1979 Conrail required $729 million in government funding, bringing the total federal investment since April 1, 1976, to $2.655 billion of the $3.3 billion authorized. Of that sum, approximately $2.360 billion—or nearly 90 percent—is represented by rehabilitated or new physical assets, plant and equipment, that will provide long-term benefits for rail service in the Northeast quadrant of the nation. Similarly, the additional $830 million in private financing that Conrail has obtained since beginning operations to acquire new locomotives, freight cars and other equipment represents a beneficial investment in the region's rail service.

The 1979 results reflect the cumulative gains, detailed later in this report, made by Conrail's vast physical rehabilitation programs over the past four years. They also demonstrate the continuing and concerted effort of Conrail employees to manage productively and to use those resources to enhance service while reducing costs.

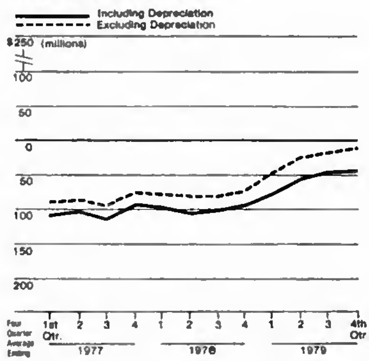
During the year, Conrail's "product"—transportation service to freight shippers—showed marked improvement, a trend that started in the latter part of 1978. The level of service improved steadily during the year, reflecting the benefits of both the physical rehabilitation of plant and equipment and improved operational management.

Conrail's high-density main lines—its core routes—have been restored to the point where they enhance, rather than impede, the operation of the railroad. Slow orders throughout the system have been reduced. The serviceability of Conrail's locomotive fleet is approaching that of most other railroads, and the deferred maintenance of the inherited fleet has been essentially eliminated. For

Quarterly Results of Operations—Actual 1976—1979



Trend of Results of Operations (Four-Quarter Moving Average)



Conrail's financial results of operations improved substantially in 1979, compared with 1978 and prior years. The top chart illustrates the Corporation's actual quarterly financial results, both including and excluding depreciation, since the first quarter of operations in 1976. The bottom chart illustrates the overall trend of those financial results on a four-quarter moving average.

the first time in its history Conrail did not experience a shortage of locomotives. Similarly Conrail's freight car acquisition and repair programs, correlated with the mix of traffic available, have reduced substantially the loss of volume due to lack of equipment. In addition, even within the constraints of the present regulatory environment, Conrail has developed and has implemented several innovative marketing programs to improve the profitability of certain traffic and to offer new services to shippers.

The result of all these achievements—a combination of physical improvements, operational effectiveness, and marketing initiatives—is that Conrail today is "a rail freight system that's back on the track," functioning constructively in support of the Northeast economy and as an integral part of the national railroad network.

Yet it is clear that major obstacles, many of which are not wholly within Conrail's control, continue to impede the path toward establishment of financially self-sustaining operations.

- Timely and fundamental reform of the archaic rail regulatory framework is essential to allow Conrail and other railroads to shape prices and services to the transportation marketplace. At this time legislation to modify the regulatory framework is moving within both houses of Congress, the timing and extent of such reform remain uncertain. However, the Interstate Commerce Commission continues to move in its decisions towards a freer market.
- In general, the economy of the Northeast quadrant of the nation—and particularly its heavy industry components—has lagged behind that of the rest of the United States, continuing a long-term trend of decline in rail tonnage in the region.
- A key expectation of the Final System Plan—that Conrail would benefit from a major increase in coal tonnages—has failed to materialize, thus Conrail has not benefited from the revenues that would have been generated by that increase.

There are other problems as well, including potential Conrail liability for labor protection provisions of the Regional Rail Reorganization Act of 1973, as amended, increased car hire charges resulting from Interstate Commerce Commission decisions, potential increases in rail retirement taxes, and, despite provisions of law to the contrary, the fact that Conrail continues to bear financial burdens from the passenger and commuter services it operates under contract.

None of these circumstances relieves the Corporation of its responsibility to continue improving rail freight service while striving for financial viability. They do indicate, however, that Conrail today is at a critical juncture and that Conrail's ability to achieve its mandated goal of financial self-sustainability is dependent upon favorable action on a number of public policy matters.

The experiences of the past, combined with the realities of the present, dictate the need for caution in projecting the resolution of these issues. However, Conrail continues to plan its operations around the assumption that developments in these critical matters of public policy and in the economic climate will enable it to operate within the limitations of the existing $3.3 billion authorization.

Based on the substantial accomplishments of the past four years, we are confident that Conrail will make increasing progress in providing improved transportation service to the freight shippers of the Northeast and Midwest.

Edward G. Jordan
Chairman and Chief Executive Officer

Stuart M. Reed
President and Chief Operating Officer

Conrail in 1979

A rail freight system that's back on the track

Aftsr 45 months of intensive rehabilitstion, snd continued emphasis on productively mansging these resources, Conrail in 1979 began to provide a level of service that met most of the rsil trsnsportation needs of its shippers in the Northesst and Midwest regions. Moreover, this service is benefiting the interline movement of freight with csrriers of othsr regions, strengthening an important link in the national economy.

Customer service

Significant progress was made by Conrail in 1979 by managing its substantially restored plant and equipment to provide improved freight service to its customers.

The Corporation strengthened the management of the transportation function of its operating department, adding s new service control and trensportetion analysis unit, snd its complement, a new service plsnning unit in the marketing and sales department, thereby equipping msnagement to trsnalels promptly customsr servics requirements into better operations.

Conrsil's keypoint quality control msesurement, which monitors service quelity on e carload basis, improved every month in 1979 over the same month in 1978, ending the ysar with 76.9 percent of ell monitored cerloads erriving within 24 hours of schedule.

Car supply—a key ingredient to better service—also improved in 1979 as a result of continued emphesis on improving the overell condition of the revenue cer fleet snd menaging it for maximum utilization.

Car utilization

The everege utilization of Conrsit's revenue freight car tlset was ebout the same in 1979, compared with 1978. While utilizetion for the first six months of 1979 was above 1978 levels, it dropped below those levela in the second half of the yeer es business levels declined. This decreesed utilization, resulting in large part from declining business levels, wes minimized by Conrsil's car management system, which had proven its sftsctiveness eerlier in the year.

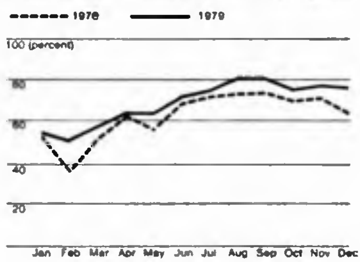
The cer management aystem was established in lats 1978. It became fully operational in 1979 and provided close supervision of the car fleet, concentreting on matching car ellocstion with customer csr requirements and minimizing car hirs costs.

This improved control of the fleet is sxtrsmely importent to Conrsil. It provides a constant snsiysis of customer equipment needs, freeing unneeded equipment for special marksting initletives. For sxample, Conrsil was able to sstsbliah two additional mini-traine for ateel shippers in 1979, for a total of 11 such trsins on ths Conrail system. In these treins, large numbers of coil stesl cara move sa units on expedited schedules in regulsr trains that sre cerefully tracked from point of origin to point of destinetion. They provide transportation cost advsntagss, fsster delivery timea snd superior cargo protection.

Good csr utilization also is important to Conreil customers who operste with their own csr fleets, such ss chemical shippers snd electric utilities. Conrail significantly increased ths utilization level of thsse private fleets in 1979. Trsnsit tims on trsffic to and from ths Southwest—e major region of chsmical production —improved substantielly in 1979. For example, transit tims between the Esst St. Louis gatewey and Conrail's origins and destinstions in New Jersey end Philadelphia decreesed from 8.1 deys in Msy to 5.6 daya in December, and the utilizetion of electric utility fleets improved 9.3 percent,compared with 1978.

Service improvements, however, wers not limited to the operetion of trsins snd the provision of equipment. Among other sfforts made in 1979 by Conreil to improve its customer relationships was the appointment of customer ssrvics reprssentetives in 23 cities. These representatives have the responsibility for solving customers' servics problema.

Loads Delivered Within 24 Hours of Schedule



The level of service provided by Conrail improved every month in 1979, compared with the same month in 1978.

Rehabilitation progress continuing

Although a significant portion of the datarred maintenance inherited by Conrell from its bankrupt predecessors hes been overcoma, subslanlial work remains to be done belora tha ovarall condition of Conrell is on a par with other major railroads. As a result, Conrell continued rebuilding its physicel essata in 1979—track, locomotives and freight cars.

Track

Track gengs in 1979 installed 3.6 million new crossties, laid more then 1,054 miles of rail end surfeced 9,525 pass-miles* of track. Tha cumulative gains made in 1979 and in tha three prior years brought Conreil's high-density main lines—its core routas—to tha point whara they enhanced, rather than impeded, the operation of the railroad.

Track work done in 1979 resulted in a nal reduction of 752 miles of slow ordars; e totel of 4,314 miles of slow ordera were ramoved, and 3,562 milas of new slow orders wara edded. At the end of tha yaer, less than 3.37 percant of Conrail's 5,110-mile core roule system remained subject to slow orders, end few of those ordera hed en impact on operations.

Increased supervision, bettar planning, reorgenization of work gengs, improved materlel availability, and improvements to maintenanca of way equipment resulted in increased productivity by track forcas in 1979. Compared with 1978, the amount of rail installed per track gang increased 40 percent, the number of ties installed per crew increased 12 percent, end surfacing per crew increased 16 percant.

In Reading, Pa., $3 million was invested in a shop that builds end repairs track components, such as "frogs" and switch points. This facility, built in e section of an existing maintanance of way equipment repair building, will enable the railroad to rebuild track components relhar than purchase them from outside sourcas.

Treck and signal changas wara complated on 255 miles of track, enebling treins to operate in either direction on a singla track. As a result of the completion in 1979 of one such project, 160 miles of railroad can be controlled from a cantral offica in Pittsburgh. Conrail employees select end monitor routas for the 135 through and local trains per day that move on Conrail's main and Conemaugh linaa between Johnstown, Pa., and Conwey Yard—one of the busiest twin-hump clessificetion yards in the world—20 milas west of Pittsburgh.

*A pass-mile is a standard production measure of surfacing output, representing one mile of track worked by a surfacing gang. Complete surfacing of the track structura frequently requires more than one pass.

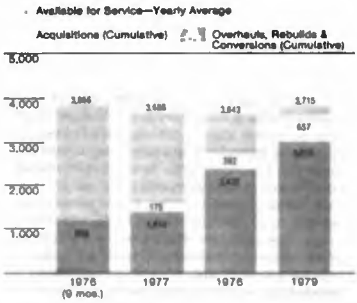
In Pittsburgh, and at a number of locations throughout the system, Conrail displayed some of the 281 new covered coil steel flat cars it acquired in 1979.

Locomotives

The serviceebility of Conrail's locomotive fleet, despita its ganarally advanced age, is now approaching that of most othar railroads in the United Stetas. In 1979, Conrail ovarhauled, rebuilt or converted 581 locomotives and acquired 265 new units. More than three-querters of tha 4,427-unit locomotiva fleet has either been upgraded or replaced since April 1, 1976. As e result, Conrail in 1979 reversed e thrae-year decline in the number of locomotives available for aervica and was able to begin maintaining its locomotive fleet at normal maintanance levels for tha first time since operetions began in 1976.

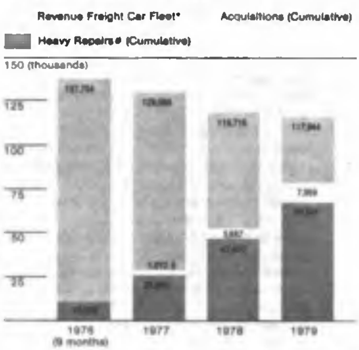
The average number of locomotives available for servica in 1979 wes 3,715, compared with 3,643 in 1978. The mean time betwaan shopping of locomotivas for repairs increased 10.2 percent in 1979, indicating continued improvemant in the overall condition of the locomotive fleet.

Locomotive Fleet



In 1979, Conrail reversed the decline in the number of locomotives in its fleet which were available for service and—for the first time in its four year history—was able to maintain its locomotive fleet on a normalized basis

Revenue Freight Car Fleet



The overall condition of Conrail's revenue car fleet has steadily improved because an increasing portion of the fleet has been either acquired new or renovated since 1976.

*Yearly average—serviceable
#The Association of American Railroads classifies heavy car repairs as those requiring 20 or more man-hours of work. Conrail's medium repairs (20 to 75 man hours) are included in the above as well as in other tabulations of Conrail heavy car repairs in this report.

Freight cars

By the end of 1979, Conrail's car fleet was capable of handling the available traffic load, and Conrail infrequently lost revenue because of an inability to supply cars. This improvement was due to the better condition of the car fleet, the traffic decline in the second half of the year, reduced transit time for loads and empties, and a better correlation between traffic mix and available car types. Contributing to achieving the latter were prioritized car repair and rehabilitation programs.

Conrail performed heavy repairs on 21,041 freight cars in 1979 and added to its revenue car fleet 281 coil steel cars, 1,518 open top hoppers and 273 enclosed tri-level cars for finished autos. Conrail also acquired 130 tops to allow conversion of open top hoppers to covered hoppers to meet peak periods of demand for enclosed cars.

Improving yards and terminals

In addition to the work on Conrail's main and secondary tracks, major rehabilitation projects at four of Conrail's key yards—DeWitt, Allentown, Oak Island, and Collinwood—continued in 1979.

Completion of the installation of electronic car classification controls and the rebuilding of yard classification and car handling tracks has transformed DeWitt Yard—located at a strategic point near Syracuse, N.Y., on the Albany-Chicago main line—into one of the most advanced freight-handling facilities on the Conrail system. The $28.2 million renovation program was completed in 1979, contributing to freight service improvements in upstate New York, Montreal and New England.

Work on Conrail's Allentown (Pa.) Yard—a $13.2 million project to convert two outmoded yards into a single, modern facility—was nearly complete by the end of 1979. When the project is finished, improvements will allow faster switching and classification of freight bound to and originating in the Lehigh Valley, and speed through-movements of freight between major Eastern and Western markets.

At Oak Island Yard, near Newark, N. J., accelerated construction brought a three-year, $19.1 million project to 75 percent of completion in 1979. These improvements will permit the consolidation of many of the operations now being performed in Conrail's Elizabethport, Waverly, Brills and Meadows yards, thus increasing the efficiency of the movement of traffic throughout the northern New Jersey area.

Work also continued on Collinwood Yard, near Cleveland, which was 65 percent complete by the end of 1979. When the $3.6 million project is finished, Conrail expects substantial service improvements for traffic generated by industries in

Cleveland and northeastern Ohio.

In 1979, Conrail also began improvements to its Elkhart (Ind.) Yard, a critical gateway for traffic from the West. The project will provide extended classification tracks, improved switching capacity, and better facilities for expediting the make-up and dispatching of trains. Work completed in 1979 included the engineering and design for the entire three-year project, and the beginning of actual construction.

Conrail, in 1979, continued to make improvements to the track in its system of yards and terminals. At these facilities, Conrail track forces installed a total of 853,722 new crossties, 87 miles of rail, 954 new turnouts, 21 new retarders, and surfaced 1,849 pass-miles of track.

Improving terminal operations

Yard and terminal costs consume a considerably larger portion of Conrail's revenue than on other major railroads because of the complex terminal network required to service the eastern portion of the Conrail system. In addition to rehabilitating its yards and terminals to cut these costs, Conrail is pursuing a terminal study and improvement program to make the operation of its yards and terminals more productive and efficient.

As part of that effort, Conrail analysts, through 1979, have studied more than 1,900 crew assignments at 300 crew reporting locations, formulating and implementing programs to improve operations. Among the resulting changes have been physical upgrading of yards, changes in yard layouts, new rail connections, revision of switching patterns and better utilization of manpower.

The program has had a positive impact on yard and terminal operations. For example, productivity, measured in terms of cars dispatched per crew hour, improved every month in 1979 compared with 1978. Perhaps of more significance, the improvement continued in the last three months of 1979 despite the decline in traffic.

In addition, Conrail has pursued a program to increase the flexibility of its terminal workforce by integrating personnel from former railroads at each terminal into one consolidated terminal operation. By the end of 1979, that program was 76 percent complete.

Conrail also reorganized its intermodal terminal operations in 1979. This move improves management control by placing the responsibility for two critical areas of terminal costs—loading and unloading expenses, and equipment repair and maintenance costs—with the terminal manager. Further, this change helps to provide for a unified business strategy to manage Conrail's general merchandise traffic.

Pricing actions

Efficiencies and cost reductions, however, cannot in themselves ensure that Conrail will reach its goal of financial self-sustainability. Another key part of the effort to reach that goal involves pricing properly the services Conrail provides.

Conrail has based its decisions to raise and to lower rates for specific services on the results of detailed market studies, defining business segments handled by Conrail that are profitable, as well as those that are unprofitable. To improve its market position with those commodities that are profitable, Conrail has upgraded service, and in some cases, reduced rates. For unprofitable traffic segments, Conrail has, wherever possible within the confines of the regulatory environment, taken initiatives to improve efficiency and, thereby, profitability, or initiated rate actions to improve the contribution made by this traffic.

In working toward these goals, during 1979 Conrail continued to implement programs in line with provisions of the Rail Revitalization and Regulatory Reform Act of 1976 and recent rulings by the Interstate Commerce Commission (ICC). For example:

- Conrail has established 356 new backhaul rates to reduce empty boxcar movements and to generate new revenue since implementing the backhaul program late 1978. These rates had, by the end of 1979, brought Conrail an additional 3,500 carloads of boxcar traffic worth $2.3 million in new revenue.
- Following deregulation of transcontinental movements of fresh fruits and vegetables by the ICC in May, Conrail took both price and service initiatives. Customers shipping perishables from California to Boston, New York and Philadelphia reaped the benefits, as did Conrail. Service improved, prices reflected market conditions and Conrail increased its tonnage. Prior to deregulation, Conrail tonnage derived from perishables dropped 42 percent in the first six months of 1979 compared with the first six months of 1978. Revenues were down 45 percent. Following deregulation, in the last six months of 1979, tonnage increased 15 percent from 1978, and revenues increased 37 percent compared with the same period in 1978.
- Conrail filed 24 surcharges with the ICC in 1979 to correct profitability problems on certain traffic moving to Conrail from connecting railroads on joint rates. Conrail's revenue division on many joint rates (rates shared with a connecting railroad) frequently

does not cover the cost of providing the service. The surcharges are designed to ensure the continued development of adequate and viable rail service for the Northeast by establishing rates based upon market factors, rather than past customs. However, the surcharges have been intensely contested by some of Conrail's connecting railroads and some shippers.

In late October, Conrail announced a rate reduction of about five percent for more than three-quarters of its piggyback traffic and for domestic freight carried in marine containers. The piggyback rate specifically covers trailers moving between piggyback terminals on the Conrail system—ramp-to-ramp. A similar rate reduction covering marine container traffic moving on Conrail between North Atlantic ports was also made in 1979.

Shippers of perishables reaped the benefits of deregulation beginning in May, when the Interstate Commerce Commission deregulated transcontinental movements of fresh fruits and vegetables. Conrail, cooperating with its connecting carriers, was able to improve service. Rates were adjusted to fluctuating market conditions. As a result, both tonnage and revenues increased.

Attracting new business with special service

Enlisting the support of railroads in the West, Conrail initiated three service improvement programs in 1979: transcontinental piggyback run-through, through-block trains, and "Linertrains". Conrail and the Santa Fe introduced piggyback run-through service from New York and Boston to Los Angeles and Oakland, in September. Made possible by Conrail's rehabilitation of its Kankakee and Danville branch lines in Illinois, this service bypasses the time-consuming Chicago terminal complex and provides fifth-morning delivery westbound and sixth-morning delivery eastbound.

Conrail, the Chicago and Northwestern, and the Union Pacific also initiated through-block piggyback service from New York to Los Angeles in September. Cars are grouped in trains according to destination, allowing faster transfer at intermediate points.

"Linertrains," a part of mini-landbridge movements from the West Coast to the East, offer shippers from the Far East a faster, low-cost alternative to shipping cargo on an all-water route via the Panama Canal. Conrail moves these 50-car trains from Chicago to its TrailVan facility at South Kearny, N.J.

Employment levels

Since conveyance, one of Conrail's goals has been to improve efficiency and to reduce the cost of operations. The resultant reduction in the size of its workforce continued in 1979, and was accelerated with layoffs at the end of the year as traffic declined, bringing the number of employees more in line with traffic requirements forecast for early 1980. As a result, Conrail's average employee count in 1979 was 87,500—3,800 below the 1978 figure and 7,958 below the 1976 average. Excluding employees in passenger service and other reimbursable operations, as well as those needed for capital programs, Conrail's average employee count during 1979 was 68,875—or 3,883 below the comparable measure for 1978 and 9,920 below that average for 1976.

Labor agreements

In 1978 Conrail signed a landmark labor agreement with the United Transportation Union. That agreement was designed to help the Corporation realize significant savings in train crew costs. This was done by providing for reduction, through attrition, in train crew size on most Conrail freight trains and by the development, by September 1, 1979, of a single agreement for all employees represented by the United Transportation Union. This established a single set of work rules for train

crews. The anticipated level of savings in train crew costs did not materialize in 1979 because of the decline in traffic and improved efficiency in operations during the last six months. This resulted from the terms of the agreement, that provided that protected employees—those hired before September 8, 1978—had to be used to fill second brakeman positions on train crews which had previously been reduced in size under the agreement before they could be furloughed.

Due to considerable differences of opinion within the union concerning the process that should be followed in concluding the single agreement with a uniform set of work rules, Conrail was unable to complete it as scheduled. This has delayed the presumed benefits associated with the simplicity of single agreement over the whole railroad as contemplated by the 1973 Rail Reorganization Act. However, in early 1980, the union's leaders agreed upon a process of arbitration designed to achieve the single agreement.

Consolidation of other labor agreements continued in 1979. In its first 45 months of operation, Conrail has negotiated 19 new single

In 1979 Conrail launched a number of new TrailVan services, including transcontinental run-through trains operating between the East Coast and West Coast. Above, one of the new trains speeds through upstate New York.

class and craft collective bargaining agreements, replacing 177 agreements inherited from the former lines.

Affirmative action

Of the employees hired in 1979, 36 percent were minorities and women. As a result, the proportion of minority employees remained stable and the proportion of female employees increased by 10.7 percent despite a substantial decrease in the overall size of the workforce. Minority and female employees now constitute 13.3 percent of Conrail's work force.

Conrail's program of identifying qualified minority vendors and encouraging them to bid for Conrail business produced awards of $113 million to minority firms in 1979, compared with $66 million in 1978.

Conrail and coal

Conrail hauls more coal than any other single commodity. In 1979 coal totaled 76 million tons, representing 29 percent of Conrail's total tonnage and 12.6 percent of total freight revenues. While substantial, these figures are disappointing since actual tonnage in recent years has fallen short of that projected, and expectations for increased coal usage have failed to materialize. For example, the Final System Plan issued in 1976 anticipated wide-scale conversion to coal of oil-fired generating plants and projected that in 1979 Conrail would carry 98.7 million tons of coal.

When the oil embargo was in affect in 1973 and 1974, there was renewed interest in coal; conversion of generating plants from oil to coal was widely heralded as the answer to dependence on foreign oil. It was in this atmosphere that the United States Railway Association prepared its blueprint for Conrail's future operations. It forecast significant increases in coal traffic moving over Conrail lines in anticipation of the nation's swing away from oil.

Once the oil embargo was lifted, however, and oil again became plentiful, albeit more costly, the urgency to convert to coal waned, and conversions from oil lagged. As a result, the anticipated increase of coal traffic on the rails failed to materialize. While today that tonnage might be viewed as postponed—rather than lost—to Conrail, its absence substantially diminished Conrail's revenues and impeded its efforts to achieve financial self-sustainability.

Now events in Iran and elsewhere again have focused this country's attention on coal as the most plentiful, reliable source of energy for the nation's immediate future.

When the Northeast is ready to produce and to sell more coal, Conrail will be ready to move it. Since April of 1976, through the end of 1979,Conrail has acquired 5,492 new 100-ton open top hopper cars for coal, rehabilitated more than 18,000 hopper cars, and concentrated on upgrading lines serving the coal fields.

Coal is vital to the nation's future—and the decision as to when it will be more extensively utilized is essential to Conrail's ultimate achievement of financial self-sustainability.

Passenger services

Conrail operates intercity rail passenger service for Amtrak outside of the Northeast Corridor, and as an independent contractor, provides suburban rail commuter services for state and regional agencies. The states and agencies involved are the New York Metropolitan Transportation Authority, the Connecticut Department of Transportation, the New Jersey Department of Transportation, the Southeastern Pennsylvania Transportation Authority, and the Maryland Department of Transportation.

Amtrak and the commuter agencies establish policy for fares, frequency of service, station stops, and levels of maintenance for cars, locomotives, stations and track. Conrail's contractual responsibility is to provide the services specified as efficiently and economically as possible. This includes the operation and control of trains, and with regard to the suburban rail services, staffing of stations, and maintaining or arranging for others to maintain equipment, track and other facilities.

There are major problems associated with the services Conrail provides to Amtrak and the commuter agencies.

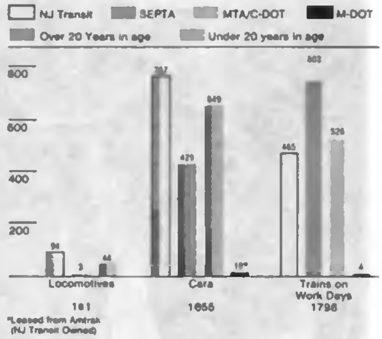
Amtrak

During 1979, the on-time performance of Amtrak trains operated by Conrail on the routes outside of the Northeast Corridor improved substantially, reflecting the improved condition of Conrail's main lines. By January 1980, Conrail was operating these off-corridor trains at more that 80 percent on-time, compared with 45 percent on-time in January, 1979.

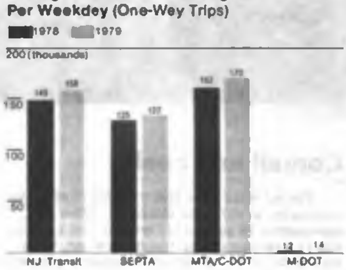
Conrail continues to face problems relating to the current and potential impact of Amtrak's Northeast Corridor Improvement Project. During 1978, when the project began, and in 1979, a number of corridor tracks were removed from service, and passenger trains were given priority on the remainder. As a result, freight trains experienced numerous delays, increasing Conrail's operating costs. Until the project is completed, which is estimated by Amtrak to be in 1985, these delays and costs will continue.

Conrail's major concern with the project, however, is with regard to the future. It is entirely possible that the benefits flowing from the project to passenger operations will be greatly diluted, if not offset, by the additional costs imposed on the movement of freight. This could result from increased numbers of passenger trains causing delays and increased costs to freight trains operating in the corridor and from the exceptionally high cost of maintaining the corridor to high-speed passenger standards, which—if passed through to Conrail and its customers—could adversely impact traffic levels.

Authority-Owned Equipment Operated by Conrail



Average Number of Passengers Per Weekday (One-Way Trips)



These graphs illustrate the amount and age of the assets committed by each of the agencies and states to the suburban rail commuter service Conrail operates for them and the substantial increase in the number of passengers carried on the average work day for each service in 1979, compared with 1978. Failures and shortages of equipment, overcrowding of passengers during peak hours and a general decline in service, were exacerbated in 1979 by an increase in ridership without corresponding improvements to the size or quality of the rail commuter fleets, because of inadequate funding for commuter agencies.

Commuter

In practically every case, the commuter services are being strained to the limit by a steady rise in ridership, spurred by soaring gasoline prices and energy conservation programs, and by the inability of the rail commuter contracting agencies to provide funds for additional rail equipment and service.

The problem has been compounded by many years of inadequate funding of these agencies,which has resulted in the use of obsolete equipment and the deferral of adequate levels of equipment maintenance. As a result, failures and shortages of equipment, overcrowding of passengers during peak hours, and a general decline in the quality of service are occurring.

The agencies are trying to meet their financial needs for current operations by increasing fares and by obtaining additional funding from other public sources. Substantial supplemental funding for the contracting agencies is also needed to meet requirements for increased routine maintenance to assure reliability in operations, and major repair programs for agency-owned electric cars, locomotives and coaches, which are either unreliable or are stored awaiting rebuilding.

Because passenger fares do not cover the costs of operating the commuter services, the sponsoring agencies must provide the additional funds to compensate Conrail for that portion of the operating costs not covered by passenger revenues. The Federal government assumes a share of these costs with grants to agencies.

In addition, Conrail is currently negotiating with two of the agencies, seeking to have them assume a share of the fixed costs associated with the provision of their service.

Moreover, contrary to the intent and provisions of the Regional Railroad Reorganization Act of 1973, Conrail has suffered adverse financial impact from its provision of contracted commuter services. As of the end of 1979, about $90 million in funds owed to Conrail by commuter authorities was outstanding. This does not include an unsubsidized deficit of more than $1 million that Conrail was forced to incur in connection with the Valparaiso, Ind., commuter service. In that case, when no offer of subsidy was made by the commuter authority, Conrail indicated its intent to discontinue service—as provided by the law. However, a series of court hearings finally resulted in the ruling that Conrail continue operating the service—at its own expense— for more than a year.

Relations with other railroads

During 1979, Conrail withdrew its objections to the proposed merger of the Chessie System with the Seaboard Coast Line Railroad, and began evaluating the potential impact on traffic flow through western gateways of a proposed merger between the Missouri Pacific and Union Pacific.

Meanwhile major problems with two other connecting railroads persisted during the year. The first concerns Conrail's relationship with the Delaware and Hudson (D&H) Railroad.

Since April 1, 1976, the D&H has not paid Conrail more than $12 million, which Conrail contends is due for trackage rights, use of facilities, and various services performed for D&H. Significant disputes exist as to the basis for billing for use of Conrail's facilities at Allentown (Pa.) Yard and Bison Yard, in Buffalo, N.Y., as well as for certain other services performed for D&H. In addition, a significant dispute exists as to the basis for billing by D&H for its line-hauling of Conrail's trains.

In December, 1977, D&H agreed to make a minimum monthly payment representing an aggregate of the estimated monthly billing for recurring items and the current diesel fuel bill, plus $167,000 to be applied to arrearages. D&H stopped making the $167,000 monthly payment in August, 1978, because, in connection with a loan agreement between D&H and the United States Railway Association ("USRA"), the Federal agency prohibited D&H from making payments on past amounts owed Conrail.

Similarly, Conrail has been deprived of considerable funds because of certain disagreements with the Providence and Worcester Railroad (P&W) dating back to conveyance and beyond. The major disagreements involve the appropriate division of interline revenues, compensation for the use of terminal facilities in Providence, R.I. and interchange arrangements. Pending resolution of these matters, each railroad has been withholding payments from the other. Excluding claims being contested in litigation, Conrail contends that the total minimum net payment due it from the P&W now totals approximately $6 million. As this report was being prepared, Conrail had recently proposed to the P&W what Conrail considers to be a reasonable and comprehensive settlement package designed to establish a rational, stable and permanent relationship between the two railroads. While Conrail would prefer that type of settlement, it is fully prepared to take the alternative course of extensive litigation.


CONRAIL
Choosing the track ahead

Choosing the track ahead

Conrail, in the 45 months since it began operations, has largely transformed the bankrupt railroads of the Northeast and Midwest into a renovated and rejuvenated rail system capable of providing adequate service to most shippers of the region. To this extent, Conrail has been successful in meeting one of the two major objectives set for it in the legislation that launched the Conrail process. However, Conrail has not yet become successful in meeting another critical objective set by the same legislation: Within the context of the existing regulatory framework, Conrail is still not in a position to forecast confidently the achievement of a financially self-sustaining operation.

The crux of the problem is the clear evidence that Conrail cannot continue to operate all of its present service, over all of its present track, under all of the existing regulatory constraints, without Federal funding beyond the $3.3 billion already authorized. While Conrail can foresee the achievement of a positive cash flow from operations alone as early as 1981, these results do not provide the financial resources for the continuing need to rehabilitate and to replenish the physical plant. As indicated in other portions of this report, Conrail, through the end of 1979, had utilized $2.655 billion of the total authorization, of which nearly 90 percent was represented by rehabilitated or new plant and equipment assets.

Conrail could minimize its need for additional Federal funding if fundamental regulatory reform occurred allowing Conrail to operate within the dynamics of the marketplace. In submitting its most recent Five Year Business Plan to the USRA in 1979, Conrail believed it to be its obligation to: (1) develop its plans to function within the funding available to it, and (2) identify changes in public policies that would decrease the likelihood that further Federal investment in Conrail will be required. Specifically, therefore, that plan is premised on two key assumptions:

1. Conrail will have available from the Federal government the currently authorized $3.3 billion and no more.
2. The Federal government will reform regulation to an extent that will enable Conrail to operate within the currently authorized funding while at the same time meeting service goals.

In anticipation that fundamental regulatory reform might not be enacted, Conrail's Five Year Business Plan provided several contingency plans involving immediate reductions in geographic scope and service and additional government financing. The fact that basic public policy decisions will soon have to be made, which affect Conrail's future, has led to studies by various organizations, including USRA and the Federal Railroad Administration as to whether alternatives for Conrail might be feasible.

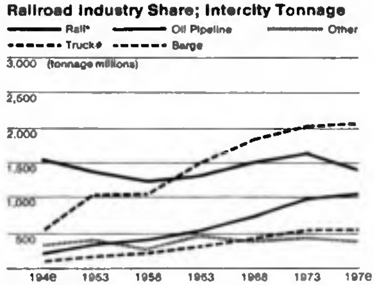
The rail problem in context

More than a decade ago a transportation crisis began. The foremost symptom—the bankruptcy of the Penn Central and subsequently of a number of other eastern and midwestern railroads—provided dramatic evidence of a far more pervasive problem: the fundamental financial ills of the entire rail industry, which—if left uncorrected—would accelerate the deterioration of the rail industry and threaten the transportation infrastructure of the nation.

The problems presented by the bankrupt railroads could not be ignored. In an unprecedented government-sponsored reorganization, Conrail was created to continue private sector railroading in the Northeast quadrant of the nation while providing a means of restoring adequate rail services to that region. Conrail thus is an ingenious development in what is an ongoing process of dealing with a larger, more pervasive railroad problem.

In creating Conrail, the basic theme of the

Railroad Industry Share; Intercity Tonnage

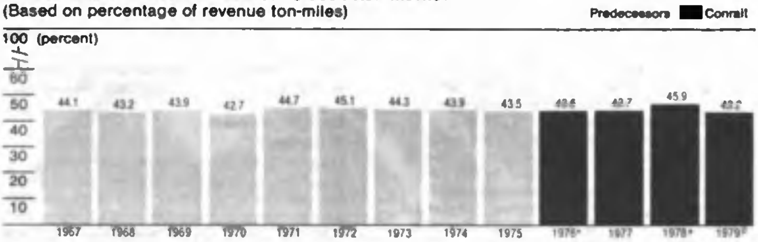


Over the past three decades, the tonnage of the railroad industry has remained relatively stable. However, the tonnage handled by other modes has grown substantially indicating a need for the rail industry to be able to make substantial changes in its market strategies if it is to share in the growth of the national economy.

*Class I and II revenue tons originated
#ICC regulated and non-regulated combined

Source: Transportation Association of America

Conrail Share of Eastern District—Class I Rail Market
(Based on percentage of revenue ton-miles)



Conrail's market share, compared with other major carriers in the Eastern District, has remained relatively stable. Thus, the tonnage and revenue problems indigenous to the Eastern District are not confined to Conrail.

*Combined Predecessors and Conrail. Conrail began operations April 1, 1976.

#The coal strike during the first quarter of 1978 and a strike against the Norfolk and Western Railway during the third quarter, 1978, extraordinarily increased Conrail's market share in 1978.

p-preliminary

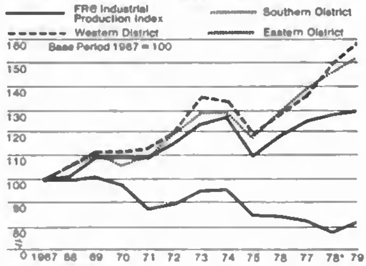
Final System Plan (FSP) was that the problem was within the mechanism of the bankrupt railroads themselves. The basic assumption of the FSP was that, if the physical mechanism were restored, the railroads would once again begin to operate successfully. The FSP wrapped that basic assumption in a projected environment relatively free of adverse external events and ripe with projected increases in freight tonnage. But adverse external events did occur, and for several reasons, the projected freight tonnage increases did not materialize.

On a national basis, competition from other modes of transportation, combined with an uneven public policy that favored their development, has eroded railroads' share of inter-city freight traffic. Between 1947 and 1977, railroads' share of ton-miles hauled was reduced from two-thirds to just over one-quarter. The difference has gone primarily to trucks, barges and interstate pipelines.

In the past three years, rail tonnage in the Northeast has continued the general downward trend of the last decade. Although Conrail has essentially maintained its market share in comparison with other major railroads of the region, the economic problems of the region and changes in its economic base continue to decrease its potential for growth.

Conrail thus is being rebuilt while the use of the rail mode in providing freight transportation is diminishing. In Conrail's case, the result is a system too large for the amount of the business available to

Railroad Traffic Trends in
Revenue Ton-Miles (Class I Railroads)



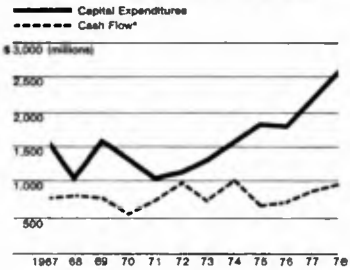
Viewed from the perspective of a 12-year period, the loss of tonnage carried by Conrail and by other Eastern District railroads is a trend that runs counter to that experienced by other railroads in the nation and to the growth of the national economy, as illustrated by the Federal Reserve Board's Industrial Production index. The index measures the physical output of the nation's factories, mines and electric and gas utilities expressed as a percentage of production in the base period of 1967. The index thus reflects changes closely related to the primary freight sources of railroading.

*The coal strike during the first quarter of 1978 and the Brotherhood of Railway, Airline and Steamship Clerks strike against the Norfolk & Western Railway during the third quarter, 1978, extraordinarily decreased Eastern District rail ton-miles in 1978.

Source: Association of American Railroads, Federal Reserve Board sustain it. And, in an inflationary environment, the increasing cost of replenishing the physical plant offsets actual progress in eliminating deferred maintenance.

In this respect, Conrail is really an acute example of a fundamental capital shortfall endemic to the entire rail industry. Illustrating the scope of the problem in dollar terms, in 1968, industry capital expenditures exceeded retained funds by about $360 million. By 1978, the gap had expanded to

Rail Industry Cash Flow vs. Capital Expenditures (Class I Railroads)



Total capital expenditures exceeded rail industry cash flow, cumulatively, for the 11-year period, 1967 to 1978, by $93 billion, and the gap continues to widen at an alarming rate. In 1968 capital expenditures exceeded cash flow by $358.3 million. By 1978, the gap had expanded to $1.833 billion, indicating there is an increasingly large and growing need for capital in the industry and a decreasing ability to provide it.

*Represents net income before extraordinary items, plus deferred taxes and retirement charges, less cash dividends and equity in undistributed earnings of affiliated companies. Beginning in 1975 cash flow is based on the 1979 Class I consist of roads excluding the Long Island Rail Road. 1967 to 1974 data is based on the consist of Class I railroads for each respective year.

Source: Association of American Railroads

more than $2.0 billion. Cash flow from internal operations and funds that can be raised from private capital markets vary from railroad to railroad, but overall they are insufficient to renew the existing plant and equipment and to provide capacity for increased levels of traffic, should they occur.

Conrail believes that the decision-making process best suited to relating revenues to services, and for determining the shape of the plant of the future, is the marketplace. Conrail believes the rail system the nation needs—and that in the long run will be most beneficial to the Northeast—is one that fulfills an essential need in the transportation system *without* burdening either the taxpayer or the economy with *unproductive* rail capacity or *unnecessary* rail service.

In contrast, the existing processes of rail regulation distort competitive forces, artificially shape economic decisions and provide non-economic answers to critical economic problems.

The need for regulatory reform

In Conrail's view, there are two principles essential to fundamental regulatory reform: First, that railroads be able to shape their fixed plant and operations to the demonstrated needs of its customers; and Second, that railroads have the right to set their own prices for the services they provide.

Shaping the system

Fundamental regulatory reform would provide Conrail the freedom to size and shape its plant and operations in response to a market-based match of supply and demand for transportation service. Government studies and Conrail's past experience indicate, however, that some shippers may not have adequate transportation alternatives immediately available. To achieve the objectives of the open marketplace, neither Conrail, nor any other railroad, should be required to provide service at less than cost. If there are shippers that require economic protection in the marketplace, such as has been provided in the past through state subsidy programs, then these subsidies should be paid directly to the shippers being benefited, rather than to the railroad.

Setting the prices

The other major criterion for fundamental regulatory reform concerns the freedom to set prices for the services provided. Here again, the primary issue is whether Conrail should continue to be used as a conduit for a subsidy—this time to other railroads and shippers of other regions.

From the standpoint of Conrail's objective of achieving financial self-sustainability, the single most restrictive aspect of existing regulation is the limitation upon joint rate changes. The current system of dividing revenues on interline movements does not recognize the geographic and economic characteristics of the Northeast region, the distinctive nature of the traffic that the region generates, or the complex, terminal-intensive pattern of its present rail system. Instead, the artificially rigid rate joint structure gives each railroad veto power over pricing changes and has led to the railroads' heavy reliance on general rate increases. At present, Conrail is unable to raise even below-cost joint rates. Interline divisions imbalances may cost Conrail as much as $150 million per year. These imbalances would require years to remedy if divisions readjustment proceedings were initiated by Conrail under existing law.

Opponents of change in the rigid joint rate structure have advanced various arguments in an attempt to obscure the fact that the existing situation benefits carriers and shippers outside the Northeast and Midwest at the expense of carriers and shippers in those regions.

Thus, the real issue posed by the existing joint rate system is whether Conrail will be able to price its services in a manner that will allow it to obtain financial viability, or whether Conrail will continue to be used as a conduit for the hidden subsidies the current joint rate structure provides.

To remedy the situation temporarily within the confines of existing regulation, Conrail is exploring the advantages of other devices such as proportional rates and route closings. Conrail has also initiated a series of surcharges added to joint rates to cover Conrail's costs on interline movements of certain commodities. These surcharges are being challenged before the ICC. At best, however, surcharges only approximate the market-based rate changes, which would be the best solution to the long-term problem.

Because of its mandate to become financially self-sustaining, Conrail has championed the cause of regulatory reform. The extent of that reform is still in doubt. But whatever shape it finally takes, the measure of its effectiveness will be the extent to which it gives railroads sufficient freedom to tailor service and investment patterns to the markets they serve best.

The consequences of change

While Conrail is back on the track and has more ability than ever before to provide good service, it also has a capacity beyond that required by the present regional economy. Where once the railroads of the Northeast were the initiators of economic growth, they are today servants of the demand derived from the existing economic environment. Conrail, and the rest of the rail industry, is engaged in a painful process of cutting away the capacity, which decades ago supported the success of the railroads, and today is a major cause of their decline. That dynamic process involves the difficult adjustment of a greater supply to a lower demand.

There is thus substantial conflict between the mandated goal of making Conrail financially self-supporting and other goals of public policy. For example:

- Decisions to reduce track mileage to cut costs conflict with the desire of retaining track mileage for future use—a desire with an added sense of urgency in view of the energy crisis. Understandably, any rail line is viewed by the area it serves from the standpoint of its future potential, no matter how uneconomic it may be by present standards.
- Decisions to reduce railroad employment levels to bring costs in line with reduced traffic and revenues conflict with the social and economic desirability of maintaining the employment base in many communities. Yet, efficient and ultimately profitable operations depend on reducing operating costs, including labor costs.
- Decisions designed to make the shipper pay a price for transportation service that at least generates sufficient revenue to cover costs understandably generate adverse reactions from many shippers. Indeed, some shippers' ability to continue in business can be jeopardized by such decisions if the business is dependent upon a hidden subsidy from rail transportation sustained by the artificial constraints of the regulatory process.

The answers Conrail must pursue to achieve financial self-sustainability require physical plant reduction, employment reduction, and higher prices for some services. These are decisions with unfavorable consequences for some segments of the public. It is therefore understandable that the larger goal of a self-sustaining economic enterprise, which is not dependent upon infusions of Federal funds, is sometimes obscured by the more immediate interests of those affected.

It is possible that changes in the economic environment will restore to railroading a greater share of the nation's transportation market. The ever-larger energy problem with the price and supply of oil, and the associated potential for increased coal use, may well generate new tonnages for rail transportation. But such future needs cannot be provided for by the financial results based on present traffic trends. Clearly, the cost of having a railroad with a stand-by capacity has to be met.

Choosing the track ahead

The decades-long process of dealing with the changing shape of the nation's rail industry and of the nation's need for it thus has reached a critical point of public decision-making. The basic question, crystallized by Conrail as the "cutting edge" of the larger problem, is whether the nation continues to be interested in truly achieving a self-sustaining private sector solution to the railroad problem. If so, the nation must face the need for fundamental reform of the regulatory process now imposed on railroads and must be ready for the economic adjustments that will inevitably result. And to the extent that railroads are to be used as a means of deferring these adjustments—or for achieving other aspects of public policy, such as providing stand-by capacity or for supporting local employment—it must be recognized that the funds needed to meet the associated costs must be provided.

The question thus posed is not the question of the future of Conrail. Conrail is a valid institution only so long as it best meets the need of carrying forward the process of solving the basic rail transportation problem in the northeast quadrant of the nation—and so long as it represents the lowest possible cost to the taxpayer. Alternate solutions, of course, should be subjected to the same test.

Choosing the track ahead is a continuation of the process of change that began several decades ago with the fundamental changes in the nation's need for transportation services. That problem became a crisis with the bankruptcy of the railroads that preceded Conrail. The creation of Conrail and the progress that it has made has removed the crisis atmosphere from the problem and has allowed essential progress to be made while the complex facets of the problem became better defined. While changing external circumstances eliminated the possibility that Conrail could follow successfully the track set out for it in 1976, Conrail has successfully eliminated the crisis and has shaped the decisions that now must be confronted.

Financial review

Management's discussion of consolidated results

Conrail's operations for the year 1979 resulted in a loss of $178 million, an improvement of $207 million from the prior year loss of $385 million (the loss for 1977 was $367 million). The loss for the year was reduced by about $30 million because of a change in accounting relating to the capitalization of certain track rehabilitation costs, and additionally, the capitalization, as prescribed by the ICC, of certain equipment rebuilding costs previously expensed. About 70 percent of the year's loss occurred in the first quarter of the year. Operations in the second quarter produced a profit of $33 million, a first for Conrail. The favorable trend continued into the last half, with results of the third and fourth quarters being better than the comparable quarters in the previous year. Freight volume was adversely influenced by a softness in the demand for iron and steel products, as well as the automobile situation.

Continued attention to capital improvements, coupled with other service-oriented programs, resulted in a considerable improvement in on-time service measures throughout the year. On-time deliveries improved from 57 percent in the beginning of the year to more than 76 percent by year-end.

Revenues 1979-1978

Operating revenue for 1979 totaled $4.0 billion, a 12.8 percent increase over 1978. Freight traffic accounted for $3.4 billion, or 86 percent of operating revenues, a $378 million increase over 1978. This increase was principally attributable to the revenue yield from higher freight tariffs and fuel surcharges.

To help alleviate the impact of inflationary costs in 1979, the ICC approved freight tariff increases of 7.0 percent on December 15, 1978, and 8.5 percent on October 15, 1979. Fuel surcharges totaling 4.7 percent were granted at various times in 1979 to compensate for fuel price increases.

Freight volume in 1979 totaled 94.2 billion net ton-miles, about the same level as 1978. However, commodity traffic changes include the adverse effect of steel plant closings, automotive production cutbacks, dock strikes and unstable economic conditions. Carload declines were experienced in most commodities, particularly ore, 20 percent; coke, 25 percent; transportation equipment, 11 percent, stone, clay and glass, 9 percent, and food products, 6 percent. Farm products increased 7 percent over 1978, and coal was up 13 percent due principally to the effect of the prolonged coal miners' strike in 1978.

As in past years, Conrail has continued to provide commuter and long-distance passenger service under agreements with various agencies that generally provide for reimbursement of costs incurred in the operation of those passenger services. However, these reimbursements are frequently delayed or contested so as to cause adverse financial impact.

1978-1977

Operating revenues in 1978 of $3.5 billion were $211 million or 6.4 percent higher than 1977 due in large part to freight rate increases granted during 1977 and 1978 that averaged 6.9 percent. Freight traffic accounted for $3.0 billion or 87 percent of 1978 operating revenues, a $194 million increase over 1977. Net ton miles for 1978 totaled 94.3 billion, approximately the same level as 1977, despite the coal miners' strike and severe weather conditions early in the year that adversely affected freight volume. Unfavorable commodity traffic changes were experienced in most principal revenue producing commodities except for coke, metallic ores, and primary metal products which were above 1977 levels.

Operating costs and expenses 1979-1978

Operating costs and expenses totaled $4.1 billion for 1979, $240 million, or 6.2 percent above 1978. Labor costs, the largest portion of overall operating costs totaled $2.2 billion in 1979, consuming approximately 57 cents of each revenue dollar. Increased wage rates, including taxes and fringe benefits, totaled $207 million more than 1978. Productivity improvements in 1979, which resulted in an average reduction of over 3,800 employees from the 1978 level and other efficiencies, decreased labor costs approximately $75 million in 1979. Diesel fuel prices rose 76 percent during 1979, requiring a total expenditure of $284 million, an increase of $90 million over 1978.

Material, supplies and other costs increased $175 million in 1979 due to inflationary price increases. Maintenance, repair programs and volume-related changes from 1978 reduced costs by $152 million.

1978-1977

Operating costs and expenses totaled $3.9 billion in 1978, $233 million or 6.4 percent over 1977. Labor costs in 1978 accounted for $2.1 billion of operating expenses. Wage rate increases in 1978 totaled $133 million above 1977 levels, while productivity improvements and efficiencies decreased labor costs approximately $55 million. During 1978 there was an average reduction of 3,300 employees from the previous year's level. Other cost increases in 1978 accounting for $155 million were: material and supplies, $6 million; equipment and joint facility rents, $19 million; depreciation, $26 million; casualty costs, $49 million; interest, contract services, utilities and other cost items, $66 million; corporate and property taxes decreased $11 million.

Capital Improvements

Conrail has continued for the fourth straight year to meet or surpass most goals in the track rehabilitation program. In 1979, this program, costing $372 million, included the installation of more than 1,054 miles of rail, 3.6 million new crossties and surfacing of 9,525 pass miles of track. Slow orders (speed restrictions) on Conrail's system and core routes have been reduced 752 miles to 4,587 miles in 1979, from a peak of approximately 8,000 miles in 1976. Equipment acquisitions made in 1979, aggregating $334 million, included 265 locomotives, 2,072 freight cars and 1,992 highway trailers for trailer-on-flat-car service. Other improvements to road properties and facilities totaled $144 million in 1979.

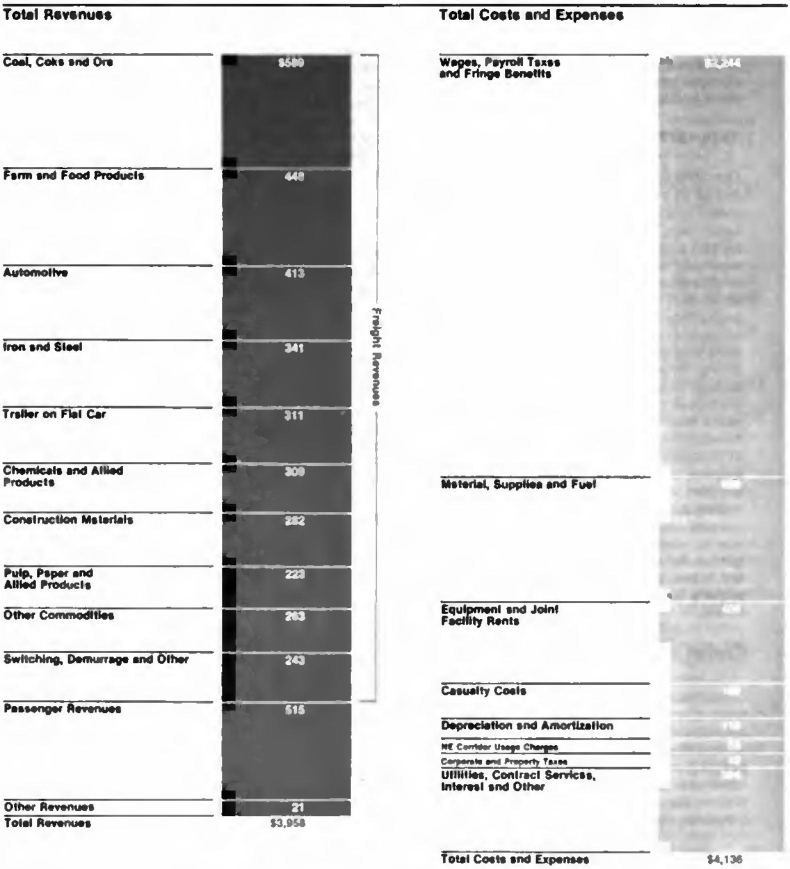
Financing

During the year, Conrail cooperated with the United States Railway Association (USRA) as it fulfilled its responsibilities for monitoring Conrail performance.

Conrail obtained $729 million through sales of Series A preferred stock to USRA in 1979. Since Conrail's inception, $2.655 billion has been obtained from USRA, leaving an authorized $645 million remaining for use in 1980 and beyond. By far, the largest portion of these funds—nearly 90 percent—is represented by rehabilitation of the physical plant, including: $1.230 billion for track, $402 million for roadway additions and improvements, $576 million for major repairs to freight cars and locomotives, and $152 million for conversions and rebuilds of equipment. In addition, in 1979 Conrail and its subsidiaries obtained private sector financing of $293 million for equipment. This brings the total private sector financing for equipment to $830 million since conveyance.

Consolidated Results of Operations

(Dollars in Millions)



Loss for the Year 1979—$178 Million

Consolidated Rail Corporation

Consolidated Balance Sheets, December 31

(Dollars in Thousands)	1979	1978*
ASSETS		
Current assets:		
Cash and temporary cash investments	$ 166,523	$ 150,888
Accounts and notes receivable, less allowances of $103,934 in 1979; $98,206 in 1978	818,870	739,257
Materiel and supplies	278,870	239,541
Other current assets	22,217	28,247
Total current assets	1,264,480	1,157,933
Investments in and advances to affiliated companies	30,392	28,942
Noncurrent receivables	87,152	107,659
Property and equipment, less accumulated depreciation and amortization	2,899,869	2,291,622
Other assets	82,991	91,374
Total assets	$4,364,884	$3,677,530
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts and wages payable	171,567	150,248
Current maturities of long-term debt	121,331	96,470
Accrued liabilities (including casualty reserves due within one year of $129,210 in 1979; $95,862 in 1978)	743,814	750,193
Other current liabilities	130,415	147,857
Total current liabilities	1,166,927	1,144,768
Long-term debt, less current maturities	1,862,317	1,734,127
Casualty reserves	96,890	91,299
Other liabilities	81,527	101,667
	2,040,734	1,927,093
Preferred stock with mandatory redemption requirements (liquidation and redemption value in 1979, $1,834,442):		
Series A preferred stock	18,344	10,304
Additional paid-in capital	1,649,865	925,293
	1,668,209	935,597
Preferred stock without mandatory redemption requirements and common stock:		
Series B preferred stock (liquidation value $1,587,019)	31,740	31,740
Common stock	25,000	25,000
Additional paid-in capital	573,260	573,260
Deficit	(1,140,986)	(959,928)
	(510,986)	(329,928)
Total liabilities and stockholders' equity	$4,364,884	$3,677,530

*Reclassified for comparative purposes.

See accompanying notes to consolidated financial statements.

Consolidated Statements of Operations and Deficit for the years ended December 31

(Dollars in Thousands Except Per Share)	1979	1978*
Operating revenues:		
Freight	$3,421,699	$3,043,450
Passenger	515,319	447,761
Other	20,827	18,900
Total operating revenues	3,957,845	3,510,111
Operating expenses:		
Way and structures	556,870	520,016
Equipment	1,138,144	1,141,934
Transportation	2,112,039	1,915,933
General, administrative and other	319,438	308,751
Total operating expenses	4,126,491	3,886,634
Loss from operations	168,646	376,523
Other expenses (income):		
Interest	85,264	81,184
Other, net	(75,714)	(72,351)
	9,550	8,833
Loss	178,196	385,356
Deficit, beginning of year	959,928	572,734
Accretion to redemption price of Series A preferred stock	2,862	1,838
Deficit, end of year	$1,140,986	$ 959,928
Loss per share of common stock	$ 7.24	$ 15.49

*Reclassified for comparative purposes

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position for the years ended December 31

(Dollars in Thousands)	1979	1978*
Sources of funds:		
Operations:		
Loss	$ (178,196)	$ (385,356)
Depreciation and amortization	114,944	95,824
Provision for casualty losses, noncurrent	5,691	22,966
Other, net	14,696	(4,269)
Funds used in operations	(42,765)	(270,835)
Current maturities and settlements of noncurrent receivables	84,660	38,408
Issuance of long-term debt	267,862	283,326
Sales, salvage proceeds and other property transactions	53,202	57,539
Issuance of Series A preferred stock	729,750	777,258
Asset reductions related to conveyance transactions:		
Conveyed assets		189,580
Noncurrent claims receivable		210,891
Total sources of funds	1,092,709	1,286,167
Uses of funds:		
Property and equipment additions	793,511	770,309
Current maturities and payments of long-term debt	139,672	91,433
Claims for payment of Estates' obligations	44,153	52,273
Settlements with Estates and other conveyance transactions:		
Notes receivable		21,000
Liability reductions		
Long-term debt		246,191
Other liabilities		119,721
Other, net	10,985	7,402
Total uses of funds	988,321	1,308,329
Increase (decrease) in working capital	$ 104,388	$ (22,162)
Changes in components of working capital, increase (decrease):		
Cash and temporary cash investments	15,635	(845)
Accounts and notes receivable	77,613	165,328
Material and supplies and other current assets	33,299	23,901
	126,547	188,384
Accounts and wages payable	(21,319)	(15,273)
Current maturities of long-term debt	(24,861)	(25,651)
Accrued and other current liabilities	24,021	(169,622)
	(22,159)	(210,546)
Increase (decrease) in working capital	$ 104,388	$ (22,162)

*Reclassified for comparative purposes

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies:

Industry: The Consolidated Rail Corporation was established on October 25, 1974, pursuant to the Regional Rail Reorganization Act of 1973, as amended (the Act), to acquire, operate and rehabilitate rail properties of railroads in reorganization (Estates) in the midwest and northeast regions of the United States. Pursuant to the Act, such properties were acquired on April 1, 1976. The Company's operations are predominantly in the railroad industry.

Principles of Consolidation: The consolidated financial statements include the Company and its subsidiaries. Investments in 20% to 50% owned companies are recorded under the equity method; less than 20% owned companies are stated at cost.

Material and Supplies: Inventories are valued at the lower of cost, principally weighted average, or market.

Property and Equipment, Depreciation and Maintenance: Property and equipment are recorded at cost. Additions and renewals constituting a unit of property, including replacement of track structure, and improvements are capitalized and depreciated over their estimated useful lives based on a composite straight-line method. The cost of depreciable property retired or replaced less salvage is charged to accumulated depreciation and generally no gain or loss is recognized. Expenditures for repairs and maintenance are charged to operations as incurred.

Casualty Losses: Losses from casualty and accident claims are charged to operations as incurred, including estimates for claims and losses incurred but not yet reported.

Pensions: Pension expense is based on normal costs and amortization of prior service costs over 40 years, and is funded through contributions to trust accounts.

Accretion to Redemption Price of Series A Preferred Stock: Differences between the mandatory redemption price and the fair market value of Series A preferred stock issued in lieu of cash interest on the 7.5% debentures are charged to retained earnings (deficit) over the period to redemption.

Per Share Data: Loss per share is based on the average number of common shares outstanding after increasing the loss for accretion to the redemption price of Series A preferred stock.

2. Passenger Operations:

The Company operates certain commuter and intercity passenger services on behalf of various entities including National Railroad Passenger Corporation (Amtrak) and various state and local governmental transportation authorities. Such operations are provided in accordance with various agreements, including interim agreements with Amtrak covering maintenance of equipment and use of Northeast Corridor properties. Under the Act, the Company is reimbursed for commuter losses incurred based upon standards issued by the Rail Services Planning Office (RSPO) of the Interstate Commerce Commission (ICC) or the terms of the separate agreements with the transportation authorities. Reimbursements of intercity passenger service costs are made to the Company in accordance with the Rail Passenger Services Act. Subsidies and cost reimbursements of $335,814,000 and $287,836,000 are included in passenger operating revenues for 1979 and 1978, respectively.

3. Property and Equipment:

At December 31, property and equipment were comprised of:

	1979	1978
	(Dollars in Thousands)	
Roadway	$1,900,401	$1,450,598
Equipment	511,718	461,445
Less accumulated depreciation	(241,931)	(177,939)
	2,170,188	1,734,104
Equipment under capital leases	843,952	619,599
Less accumulated amortization	(114,266)	(62,081)
	729,686	557,518
	[illegible]	$2,291,622

4. Long-Term Debt:

At December 31, long-term borrowings were comprised of:

	1979	1978
	(Dollars in Thousands)	
7.5% debentures	$1,000,000	$1,000,000
Government loans for Estates' obligations (see Note 10)	73,188	68,811
Equipment obligations	152,424	187,589
Capital equipment leases	752,463	567,969
Other	5,673	6,228
	1,983,848	1,830,597
Less current maturities	121,331	96,470
	$1,862,317	$1,734,127

Under the terms of the Amended and Restated Financing Agreement dated May 10, 1979 (Financing Agreement) between the United States Railway Association (USRA) and the Company, USRA has invested $1 billion (authorized limit) in 7.5% debentures. The Financing Agreement contains a number of restrictions, including those relating to the maintenance of certain levels of working capital and stockholders' equity, incurrance of indebtedness and payment of dividends.

The 7.5% debentures have preference in liquidation over the equity securities and are convertible into Series A preferred stock at the option of the holder at a ratio of 10 shares per $1,000 of debentures. The debentures are callable without penalty and must be redeemed beginning in 1986 under certain circumstances, which include payment of interest on the debentures, payment of dividends on the preferred stock and achievement of certain levels of earnings. All debentures must be redeemed by the year 2011.

Interest on the debentures is payable in cash, under certain circumstances if available, or otherwise in shares of Series A preferred stock at the rate of one share for each $100 of interest. At December 31, 1979, 503,425 shares having an estimated fair value of $2,452,000 are payable for interest accrued. The effective rates of interest on the debentures during 1979 and 1978 were approximately .3% and .1%, respectively.

Government loans for Estates' obligations are outstanding under the terms of Section 211(h) of the Act, which provides that USRA may lend up to $350 million for such use. The loans bear interest at rates from 7.66% to 13.46% and are repayable from amounts reimbursed to the Company by the Estates. Such amounts are recorded as claims receivable from the Estates. Claims not collected within three years from the date of borrowing may be transferred to USRA to liquidate the loans.

The equipment obligations bear interest at rates from 4.38% to 17% and are payable in installments over periods from 1 to 10 years. Substantially all of these obligations were recorded at present values using an effective interest rate of 8.75%. At December 31, 1979, equipment obligations were collateralized by assets with a net book value of $214,391,000 and mature as follows: 1980, $42,777,000; 1981, $32,290,000; 1982, $26,181,000; 1983, $18,178,000; 1984, $13,177,000; thereafter, $19,843,000.

For financial reporting purposes, certain equipment leases are considered to be installment purchases and have been recorded as assets and liabilities. Such leases have been discounted principally at rates from 7.32% to 10.57% and are collateralized by equipment with a net book value of $729,686,000 at December 31, 1979. Annual lease payments, exclusive of executory costs borne by the Company, are as follows:

	(Dollars in Thousands)
1980	$ 104,188
1981	109,054
1982	105,232
1983	103,140
1984	100,129
Thereafter	731,730
Total lease payments	1,253,473
Less amount representing interest	501,010
Present value of lease payments	$ 752,463

5. Noncapitalized Lease Obligations:
The Company has entered into noncancelable long-term leases, principally for equipment, which are currently not required to be capitalized. The leases generally include options to purchase at fair value and to extend the terms. The Company also participates in the joint use of trackage and facilities with other railroads. Rent expense, excluding car hire, aggregated $116,101,000 and $122,834,000 for 1979 and 1978, respectively, of which $68,235,000 and $71,327,000 relate to leases entered into prior to January 1, 1977, which otherwise meet the criteria for classification as capital leases under Statement of Financial Accounting Standards No. 13.

Minimum rental commitments under noncancelable long-term leases are as follows:

	Capital Leases	Operating Leases
	(Dollars in Thousands)	
1980	$ 64,023	$12,454
1981	58,591	11,010
1982	54,900	8,039
1983	49,519	5,103
1984	41,692	2,744
1985-1989	114,733	9,430
1990-1994	10,379	3,475
1995-1999		390
	$393,837	$52,646

The estimated amounts of the asset and liability for capital leases entered into prior to January 1, 1977, which would have been included in the balance sheets under Statement No. 13 aggregated $243,627,000 and $286,434,000 at December 31, 1979, and $300,108,000 and $335,711,000 at December 31, 1978, based upon an incremental borrowing rate at conveyance of 8.75%. Accordingly, the loss would have increased by $2,686,000 and $5,357,000 for 1979 and 1978, respectively. Amortization of property rights and interest expense entering into this computation were $43,248,000 and $27,673,000 during 1979 and $45,238,000 and $31,446,000 during 1978.

6. Income Taxes:
At December 31, 1979, the Company and its subsidiaries had net operating loss and investment credit carryforwards for income tax purposes, which may be available to reduce future tax payments, as follows:

Year of Expiration	Net Operating Loss	Investment Credit
	(Dollars in Thousands)	
1983		$ 49,000
1984		46,000
1985	$ 472,000	57,000
1986	389,000	52,000
1987	395,000	
1988	393,000	
	$1,649,000	$204,000

The tax net operating losses differ from the financial reporting losses principally because of additional tax deductions arising from the use of the "retirement-replacement-betterment" method of accounting for track structure; an excess of the tax basis of assets acquired at April 1, 1976, over the allocated acquisition costs; and the capitalization for tax purposes of certain repair costs, which for financial reporting purposes are charged to operations as incurred.

7. Pensions:
The Company's pension plan is noncontributory for all non-agreement employees and contributory for participating agreement employees. Certain of the Company's subsidiaries maintain similar plans. Consolidated pension expense for 1979 and 1978 was $18,739,000 and $16,642,000, respectively. At January 1, 1979, the most recent actuarial valuation date, the unfunded vested benefits for the plans amounted to approximately $60,277,000.

8. Preferred Stock with Mandatory Redemption Requirements:
The Company has authorized 40,000,000 shares of Series A preferred stock with a par value of $1 per share. Changes in Series A preferred stock during 1979 and 1978 were as follows:

(Amounts in Thousands)	Shares	Par Value	Additional Paid-in Capital
Balance, January 1, 1978	1,826	$ 1,826	$ 154,875
Issuances to USRA:			
Sales	7,737	7,737	765,963
In payment of interest	741	741	2,817
Accretion to redemption price			1,838
Balance, December 31, 1978	10,304	10,304	925,293
Issuances to USRA:			
Sales	7,290	7,290	721,710
In payment of interest	750	750	
Accretion to redemption price			2,862
Balance, December 31, 1979	18,344	$18,344	$1,649,865

Through December 31, 1979, USRA has invested $1.655 billion in Series A preferred stock. Under the Financing Agreement, the cumulative investments in such preferred stock cannot exceed $2.3 billion.

Series A preferred stock is entitled to an annual noncumulative dividend of $7.50 per share to the extent, under certain circumstances, cash is available. Each share is entitled to $100 upon liquidation with full preference over Series B preferred stock and common stock and must be redeemed at $100 per share after redemption of the 7.5% debentures (see Note 4). At December 31, 1979, the Company has reserved approximately 21.7 million shares of Series A preferred stock for issuance to USRA as follows: 5.2 million shares at $100 per share for cash; 10.0 million shares for conversion of the 7.5% debentures; and 8.5 million shares for interest in lieu of cash on the 7.5% debentures.

9. Preferred Stock without Mandatory Redemption Requirements and Common Stock:
The Company has authorized and outstanding shares of Series B preferred stock and common stock at December 31, 1979 and 1978 as follows:

	Authorized	Outstanding
Series B preferred stock, $1 par value	35,000,000	31,740,374
Common stock $1 par value	250,000,000	25,000,000

There were no changes in either Series B preferred stock or common stock during 1979 and 1978.

The Series B preferred stock and common stock outstanding were deposited with a Special Court in exchange for rail property conveyed. Series B preferred stock is entitled to an annual noncumulative dividend of $5 per share payable after full payment of interest on the 7.5% debentures and cash dividends on Series A preferred stock. Each share of Series B preferred stock is entitled to $50 upon liquidation with full preference over common stock, and is callable any time after 1987 at $50 per share after redemption of all Series A preferred stock. No dividends may be declared on the common stock until all Series A preferred stock is redeemed and Series B preferred stock dividends are paid.

USRA, as holder of the 7.5% debentures and the Series A preferred stock, voting as a single class, has the right to elect six Directors. The holders of the Series B preferred stock and the common stock have the right to elect three Directors and two Directors, respectively. These voting rights will change as the debentures and preferred stock are redeemed. The chief executive officer and the chief operating officer of the Company also serve as Directors.

10. Transactions with Estates:
During 1978, the Reorganization Plan of the Penn Central Transportation Company (Penn Central) was consummated. The effects of the Plan, as it related to the Company, included the receipt of certain long-term notes and elimination of claims receivable from Penn Central of approximately $211,000,000 and certain government and other liabilities of approximately $350,000,000. Included in the liabilities eliminated was $60,000,000 representing vacation liabilities, assumed at conveyance. This transaction and other adjustments resulted in the reduction of the cost of assets conveyed to the Company by approximately $190,000,000. The effect of these adjustments on results of operations for 1979 and 1978 was not material.

11. Contingencies:
Conveyance Issues: As of December 31, 1979, substantial uncertainties exist with respect to the assets conveyed to and liabilities assumed by the Company pursuant to the Act. It is not possible at this time to determine the outcome of these matters or the extent to which they may affect the Company. Any future adjustments to the purchase price resulting from the resolution of these uncertainties will be allocated to the assets acquired on the basis of their relative fair values at the date of asset conveyance. Such adjustments could have a material effect on the cost to the Company of the assets acquired and, accordingly, its consolidated financial position and its operating results. The following is a summary of the significant pending or threatened litigation, claims, assessments and other proceedings in which the Company is involved in connection with the conveyance.

A Special Court established by the Act has commenced proceedings to determine if the consideration received or to be received by the transferors constitutes a fair and equitable exchange for the assets conveyed. The consideration includes the securities of the Company, certificates of value which represent full faith and credit obligations of the United States redeemable in cash on or before December 31, 1987, and "other benefits." If the Special Court determines that the exchange is not fair and equitable, it may order the Company to transfer other securities to the transferors in such nature and amount as would make the exchange fair and equitable or, if such transfer does not satisfy the fair and equitable test, it may enter a deficiency judgment against the Company if the judgment would not endanger the viability or solvency of the Company. Should the Special Court determine the exchange is more fair and equitable than is required as a Constitutional minimum, it may order the return to the Company of the excess securities or other consideration. Moreover, if the consideration conveyed by the Company to the transferors is less than the Constitutional minimum, the transferors would be entitled to seek recovery from the United States Government under the Tucker

Act. Management has estimated the fair value of the securities issued to be equivalent to the net liquidation value of the assets conveyed as determined by USRA. In addition, the Company may be liable to the Federal Railroad Administration (FRA) or USRA should the Special Court determine that payments of certain equipment financing obligations by FRA and USRA were made on behalf of the Company and constitute "other benefits" to the transferors in the valuation proceedings.

Challenges to the validity of the conveyance to the Company of certain properties, the exclusion of certain contractual obligations and the exemption from taxes and interest in connection with the conveyance have been or may be asserted. The actions generally seek reconveyance of the properties and, in some instances, damages and other claims for relief. In addition, the Secretary of Transportation or USRA may, under the Act, develop proposals for further restructuring of rail properties through transactions supplemental to the Final System Plan. In connection with such proposals, the Company could be directed to transfer certain of its properties to other railroads if the requisite findings and determinations are made.

Title V of the Act provides for protective payments to qualified employees of the railroads in reorganization and other transferors consisting generally of monthly displacement allowances, termination and separation allowances and relocation expense benefits until such employees attain age 65. The Act provides a $250,000,000 fund, administered by the Railroad Retirement Board, to reimburse the cost of these protective payments. At December 31, 1979, the existing fund was exhausted. However, based upon statements in the Final System Plan, the Company believes sufficient additional funding for Title V obligations will be authorized and appropriated.

Federal Investments: Effective May 10, 1979, the Financing Agreement between USRA and the Company was amended and restated to provide for $3.3 billion in authorized investments in the Company by USRA of which all but $185 million has been appropriated by Congress. At December 31, 1979, $2.7 billion of the $3.3 billion has been invested. The Company's operations are dependent upon the long-term investments by USRA under the Financing Agreement. Prior to the Company obtaining the full amount of financing under the Financing Agreement, it must authorize an additional 1.25 million shares of Series A preferred stock. Furthermore, as a condition of obtaining the final $345,000,000, the Company must adopt and have in effect an Employee Stock Ownership Plan (ESOP) meeting certain requirements of the Act. The Company believes that it will meet all the conditions necessary to obtain sufficient funding to sustain its operations through 1980. However, federal investments in addition to those presently authorized may be required if the Company is to become financially self-sustaining on a long-range basis.

The Company has reported to USRA various conditions of possible noncompliance with the Financing Agreement. Should any of such conditions be determined to be an Event of Default, the debentures and other long-term debt of the Company could be accelerated and redemption of the Series A preferred stock could be required. The Finance Committee of USRA's Board of Directors has waived its rights with respect to those instances reported to USRA, but such waiver is limited to January 1, 1981.

Other Matters: Various claims have been made against the Company by certain transferors, states and others. The Company has or intends to assert claims against certain transferors for the recovery of amounts for which the Company believes it is entitled to be paid or reimbursed. Various other matters are pending before regulatory agencies. In the opinion of management, the resolution of these issues will not have a material adverse effect on the accompanying financial statements. The Company may be contingently liable for guarantees of funded debt or other obligations of certain affiliated companies. At December 31, 1979, such guarantees aggregated approximately $70,000,000. The Company believes that, under the Act and the Final System Plan, it is not liable as guarantor of a substantial portion of such funded debt or other obligations of certain of these affiliated companies, principally where separate guaranty agreements were executed by transferor railroads. Additionally, under certain noncancellable equipment leases, the Company is guarantor of related lessor obligations approximating $67,000,000 at December 31, 1979.

12. Interstate Commerce Commission Reporting: Reports to the ICC are based on the "retirement-replacement-betterment" accounting method for track structure under which replacements in kind are recorded as operating expenses. In the accompanying financial statements, track structure replacements are capitalized and depreciated. A reconciliation of the loss in the consolidated statements of operations and deficit to the loss reported to the ICC is as follows:

	1979	1978
	(Dollars in Thousands)	
Loss	**$178,196**	$385,356
Capitalization of track structure replacements	**335,942**	321,820
Depreciation	**(26,507)**	(25,492)
Loss reported to ICC	**$487,631**	$681,484

13. Equipment and Track Capitalization Costs: The results of operations for 1979 include the effect of adopting an ICC ordered accounting change requiring capitalization of certain equipment rebuilding costs that were previously expensed. The effect of this change was to reduce the loss for 1979 by $9,815,000 ($.39 per share). The 1979 results also include the effects of capitalizing certain costs, related to track rehabilitation, which had previously been expensed. As a result, the loss for 1979 was reduced by $20,160,000 ($.81 per share). Similar equipment and track costs expensed in prior years were not material.

14. Condensed Quarterly Data (Unaudited):

Calendar Quarter Ended	**March 31**		**June 30**		**September 30**		**December 31**	
	1979	1978	**1979**	1978	**1979**	1978	**1979**	1978
	(Dollars in Thousands Except Per Share)							
Operating revenues	**$902,955**	$759,273	**$1,035,585**	$915,894	**$983,788**	$904,859	**$1,036,517**	$930,085
Income (loss) from operations	**(127,818)**	(210,619)	**37,096**	(56,685)	**(34,401)**	(46,365)	**(43,523)**	(62,854)
Net income (loss)	**(125,008)**	(216,002)	**33,025**	(60,861)	**(37,899)**	(48,505)	**(48,514)**	(59,988)
Net income (loss) per share of common stock	**(5.02)**	(8.65)	**1.29**	(2.45)	**(1.54)**	(1.98)	**(1.97)**	(2.43)

As discussed in Note 13, during the fourth quarter of 1979, the Company changed its method of accounting for certain equipment rebuilding expenditures, which reduced the loss for the first, third and fourth quarters by $2,685,000, $2,302,000 and $1,160,000 ($.11, $.09 and $.05 per share), respectively, and increased net income in the second quarter by $3,668,000 ($.14 per share). The results for the first three quarters of 1979, as previously reported, have been restated to reflect this change. The revision of the capitalization policy for certain costs associated with track rehabilitation reduced the loss for the first, third and fourth quarters by $960,000, $7,600,000 and $4,600,000 ($.04, $.31 and $.18 per share), respectively, and increased net income in the second quarter by $7,000,000 ($.28 per share).

Auditors' Report

The Board of Directors
Consolidated Rail Corporation
Philadelphia, Pennsylvania

We have examined the consolidated balance sheets of Consolidated Rail Corporation and subsidiaries as of December 31, 1979 and 1978, and the related consolidated statements of operations and deficit and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our report dated March 23, 1979, our opinion was qualified as to the Company's ability to obtain adequate financing for 1979. Because of the resolution of the uncertainties related to this matter, as discussed under "Federal Investments" in Note 11, our present opinion on the 1978 financial statements, as presented herein, is different from that expressed in our previous report.

Pursuant to the provisions of the Regional Rail Reorganization Act of 1973, as amended, the Company acquired rail properties of certain railroads in reorganization and other transferors. Substantial uncertainties exist with respect to the assets acquired and liabilities assumed by the Company as discussed under "Conveyance Issues" in Note 11. The ultimate outcome of these matters, which cannot presently be determined, could have a material effect on the cost to the Company of the assets acquired and allocation thereof and, accordingly, on consolidated financial position and results of operations.

In our opinion, subject to the effects, if any, of such adjustments as might have been required had the outcome of the uncertainties discussed in the preceding paragraph been known, the financial statements referred to above present fairly the consolidated financial position of Consolidated Rail Corporation and subsidiaries as of December 31, 1979 and 1978, and the consolidated results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

1900 Three Girard Plaza
Philadelphia, Pennsylvania
March 26, 1980

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Former Secretary of the Treasury
Board member since June 6, 1978
Committee Assignment: Audit Committee

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Executive Vice President—Aerospace, General Dynamics Corporation
Board member since May 28, 1976
Committee Assignment: Compensation Committee

Wiley A. Branton
Dean, School of Law, Howard University
Board member since January 4, 1979
Committee Assignment: Ethics Committee

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Professor-Department of Economics and Civil Engineering, Massachusetts Institute of Technology
Board member since October 30, 1978
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Stephen J. Friedman
Attorney, Debevoise, Plimpton, Lyons & Gates
Board member since October 4, 1979
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Chairman and Chief Executive Officer, Conrail
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Committee Assignment: Ethics Committee

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Committee Assignment: Finance Committee

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Committee Assignment: Finance Committee

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Chairman and Chief Executive Officer

Stuart M. Reed
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This advertisement reported Conrail's progress as of mid-1979

Mr. MADIGAN. We have a vote on the floor and we will be back in a few minutes to take up the questioning.

[Brief recess.]

Mr. FLORIO. The subcommittee will come to order. Mr. Lee?

Mr. LEE. Thank you, Mr. Chairman.

Mr. Jordan, let me say at the outset that I hope Congress can emulate the success you have had in reducing your deficit by 66 percent. We will try to do that.

Mr. JORDAN. Thank you.

Mr. LEE. Last week there was a second deregulation bill that was introduced in Congress. Would you comment as to whether or not that proposal is the kind of remedy or reform that will give Conrail the kind of latitude to continue your viability and to increase your prosperity?

Mr. JORDAN. Mr. Lee, you are referring to the second draft of the House bill rather than the Senate bill?

Mr. LEE. Yes.

Mr. JORDAN. In our judgment with only one or two exceptions which really do not have to do with the question of rate regulation, the bill essentially meets our requirements and we think in the large both as to maximum rate flexibility and the provisions on joint rate freedom that we can markedly move forward. Whether or not we would precisely achieve the dollars we analyzed last summer as fundamental regulatory reform we have not completed.

I am quite confident we will be right on the money.

Mr. LEE. Deregulation will be the kind of positive force to continue and reestablish the kind of prosperity we would like to see in the Northeast with the Conrail operation?

Mr. JORDAN. Mr. Lee, we think that legislation is a very constructive step forward for the rail industry. In answer to your question as it relates to Conrail we think that is what is needed.

Mr. LEE. Mr. Jordan, with the implementation of the Florio-Madigan deregulation bill are there any other dimensions or aspects that we need to consider to insure that Conrail with deregulation would not have to come back to Congress for additional appropriations?

Mr. JORDAN. Leaving aside for the moment the question of labor protection in the 3R title V which is a separate subject before this committee, there are probably two issues that would have to be examined over the next few years for which there are really no certain answers. They both stem from the question of revenue.

One has to do with the probable modification and the balance between the truck-rail modes as we look at the price of energy increasing. What has not taken place in the last 5 years is stabilization of the relative share between these as was anticipated in the final system plan. As a result trucks have continued to erode the intercity traffic base of the rail industry in the Northeast. If that were to stabilize it would enhance our opportunity substantially to maintain the tonnage over the system that is required.

The second dimension is also revenue oriented but stems from an entirely different aspect of the energy question and that is the movement of coal. If it turns out that the President's most recent proposal for the reconversion of utility plants in the Northeast particularly which was the first stage of this two-stage program does provide and as I recall these figures, about 40 million tons of additional coal within the Northeast and if one projects our relative share of that based on where we are today, it may be required for Conrail to get assistance in the financing of equipment or other facilities in relationship to that sharp buildup.

That is because the expectation of the use of the coal will not occur until approximately 1984. I think it was by January 1, 1984. We have to put the facilities in place before that.

We now have under careful study the hope that we would have a strategy by June 1 and I have discussed this with Secretary Goldschmidt. What total financial requirements might be involved for Conrail to meet that kind of a demand out 4 or 5 years, demand for money today with revenue coming later and whether or not such a demand might be met through a different source of funding then simply the kind of section 216 moneys that have come forward to date.

I think the Federal Railroad Administrator, Mr. Sullivan, touched on it in the sense that conceivably the kind of funding that is available in the 4R title V, specific project rate of return interest paid kind of money would be highly suitable to that kind of specific revenue opportunity.

Those two issues are still before us even with deregulation. Although they both stem from somewhat of the same fundamental question of economics and energy, they really have different aspects as we go forward.

Mr. FLORIO. Would the gentleman yield?

Mr. LEE. Yes, Mr. Chairman.

Mr. FLORIO. Do you think that the provision in the deregulation proposal authorizing greater use of contract rates in light of the prospects of greater coal utilization, provide you with an opportunity for financing capability? Perhaps entering into agreements and contracts for long-term commitments wherein the contracts themselves may provide you with the opportunity to obtain financing on the basis of the contracts in the private market?

Mr. JORDAN. Mr. Florio, it would be speculative for both of us to presume somebody such as a bank or otherwise might in today's financing conditions be prepared to finance a piece of paper which is really what we are talking about. It is certainly true that for large parts of the rail industry including Conrail that revenue equipment and even locomotives in some cases are financed on the basis of the rate taking into consideration the fact that the equipment is being owned by the user rather than the carrier.

There are other facilities that are involved which are typically not financed that way and in fact would under the terms and conditions of the financing agreement we presently have with the Government be a contradiction.

For example, further rehabilitation of certain coal lines. The rebuilding of coal docks at water where we would bring the rail in; one of those is in the Philadelphia area. I think you are familiar with it. It is pier 124. There is also a dock in New York which is now under consideration and there are ore and coal docks along the lakes that would have to be rehabilitated.

We estimate the total funding for those to be about $100 million. It is perfectly possible we can find that through the private sector if we had guaranteed contracts as we could the equipment. It is speculative at this point as to what might happen and that is the reason we are thoroughly examining the question to see whether or not it is the best way to go.

Obviously you have to give up some of the profitability of that traffic if somebody else puts up their money.

Mr. FLORIO. Thank you.

Mr. LEE. Mr. Jordan, I recently had the opportunity to talk with some of the shippers who are grossly concerned about deregulation and sort of coming from the opinion that with deregulation Conrail or other providers of rail service will use that as a means of pricing the shippers out of business.

Could you comment on that, please?

Mr. JORDAN. I concur.

Mr. LEE. They have a right to be grossly concerned?

Mr. JORDAN. Absolutely. There has never been any question in my mind that some shippers on an individual basis will probably be deprived of rail service as it presently exists today. The question for those shippers is whether or not somebody else, another shipper or carrier or the taxpayers is not already subsidizing in some form their rail transportation as I would submit to you the rail industry has been subsidizing the highways in order to provide truck rates that are too cheap.

On the other hand as we have testified before this committee before and as stated in our plan it is not simply that rail rates are going to go up, it is that rail rates on noncompensatory traffic will go up but rail traffic that is competitive where we can bring the price down and increase our volume on a contributory basis will in fact will come down. By eliminating the losers we gain on the winners. We have the money to support them and so on.

I do not think one ought to address this question simply on the one side. It is both things that will happen.

I think there was an interesting editorial in the Wall Street Journal in the last week which identified the relative success of air deregulation even for the small cities who for a period of time did have trouble but now are finding themselves with more and more flights available to them.

I think as a country we have to be prepared to pay for what it is we want; not to assume somehow it can be given to us.

Mr. LEE. Mr. Chairman, I will yield to you.

Mr. FLORIO. I would just make the observation that I am not sure the airline deregulation analogy is appropriate in all contexts. Obviously there is no great ease of access into the market in terms of railroads. We are not going to have too terribly much by way of new railroad competition as the expectation is. We would have some airline competition by virtue of ease of entry.

I am not sure that on all fours the analogy works.

Mr. JORDAN. I agree with you, Mr. Florio. I would add as has been identified by the Interstate Commerce Commission, all but about 15 percent of rail traffic is competitive by other modes.

Mr. FLORIO. We have a vote and we will return shortly.

[Brief recess.]

Mr. FLORIO. The subcommittee will come to order.

Mr. Lee?

Mr. LEE. Thank you, Mr. Chairman.

Mr. Jordan, the question of condemnation about efficiency of Conrail I have heard in other forums either for or against efficiency. Can you comment on that particular aspect?

Mr. JORDAN. I think it is a fair comment that the railroad is less efficient than it should be or could be. I suppose there are perhaps two further observations that are germane.

It was a turkey when we took it over if you remember. It was called hopelessly bankrupt. It was not a thing of beauty. In that context I think it has been improved and I think most of those same folks that would comment on its present inefficiency would indicate that its capacity to do business with them on an interchange basis or on how things are done is really quite competitive.

I would say the question of measuring efficiency is a relative one and not an absolute one. As has been characterized by others in the industry and commented on earlier in this forum there is a portion of the railroad east of something called the firewall and it is often described as far west as Pittsburgh/Buffalo but sometimes it is Harrisburg/Buffalo and that is considered to be high cost. It is high cost because of the nature of the operations that exist within that area; terminal intensive; switching operations; no long hauls; its business which is in some cases a condition of the past and others that is not.

The overall impression that these people have is it is very expensive to operate there. It principally does center around the Northeast corridor where we have differences with Amtrak over the allocation of costs on the corridor operations about which we have testified previously.

Is it we are not as efficient as a railroad that operates in an entirely different part of the world or is it that we are performing functions that are really quite a bit different than what are required in other parts of the country?

Mr. LEE. Mr. Jordan, the point on the GAO report making the allegation that Government investment is jeopardized; do you concur with that or would you comment on their finding?

Mr. JORDAN. I do not concur with it. I have informed Mr. Staats that the expectation that is printed in the report that they had our agreement was wrong.

I think the testimony which I have given is pertinent to this. It is not an investment if you keep putting money in. One of the interesting observations one can make about the General Accounting report is there is absolutely no effort to trace the value of further funds appropriated nor was there in the testimony earlier this morning to an explicit return in relationship to the cost of that investment.

It is our view as the Board of Directors and management of the company that it is more foolhardy to put money in without any evidence of return than it is to solve the structural problems and the fundamental questions that exist within the territory we serve.

I do not agree with it. I do not think the Government is undergoing an unacceptable risk. I think that is an overstatement of some magnitude.

Mr. LEE. Thank you, Mr. Jordan. Thank you, Mr. Chairman. I yield back my time.

Mr. FLORIO. Ms. Mikulski?

Ms. MIKULSKI. Thank you very much, Mr. Chairman.

I have two points I want to consider. Mr. Jordan, on page 5 and 6 of your testimony you have indicated that traffic has declined in the Northeast corridor for 30 years and the decline in freight over the past 3 years is just part of the overall trend.

We are all aware of why freight traffic in the Northeast corridor declined over 30 years; the increased shifting to highway oriented modes, primarily trucking.

My concern is do you actually see this as a permanent trend that freight system is going to continue to decline in the Northeast corridor or do you see it bottoming out?

Do you feel we are now stabilized or do you think this trend is going to continue?

Mr. JORDAN. Ms. Mikulski, may I ask you one question? You inserted the word "corridor." I know the Northeast corridor is a principal preoccupation. I have referred to the entire region in the Northeast. May I assume you mean the entire region as opposed to the corridor itself?

Ms. MIKULSKI. Yes. Pardon me. I am obsessed with the Northeast corridor.

Could you answer it from both perspectives; one, the overall Conrail system and, two the Northeast corridor?

Mr. JORDAN. I think that is a very appropriate breakdown. If you look at the decline in manufacturing employment as a principal statistic you will find that the States of New Jersey; New York, and Pennsylvania have shown absolute declines in manufacturing employment in the last decade whereas the midwestern part of the operations that we serve, Ohio; Indiana, and Michigan have not in fact shown a decline but levels of employment that are perhaps a little less than the national average but still showing some absolute growth.

If you divide our railroad into those same two parts you will find those States I just referred to plus New England, we probably represent 70 percent of the rail service in that part of the country whereas in the western part we have extensive and very strong competitive from major and smaller class 1 railroads.

The difference in growth is really between the two parts of the region that we serve totally. It would be my overall judgment that it is unlikely in the next 5 years that there will be appreciable changes in the level of freight moving by rail as opposed to truck. That is not a very precise way of putting it.

The trends of truck eroding share of rail will continue over the next few years unless or until there is some better accounting for the total costs of truck both in the form of energy and the highway cost in relationship to rail service. I think they are out of balance today.

I think we have actually subsidized as Congress has indicated the cost of energy in this country and encouraged less efficient uses and I think there is absolute evidence that heavy trucks are deteriorating the highway system and not paying their full share.

At the time that shift occurs, that is the balance between those then it would be my expectation that you will find rail transportation beginning to come back if we have been able to preserve it in place. I think between now and then I would expect with the exception of coal as I indicated earlier in response to Mr. Lee's question, I doubt very much that there will be appreciable change in the trends of anything else. I regard coal as a separate category and that depends a great deal on the energy policies which the country evolves.

Ms. MIKULSKI. Coming back to the Northeast, do you feel we need two separate corridors, one for freight and one for passenger?

Mr. JORDAN. If you intend to continue to exploit the possibilities of passenger service on a high speed basis between Washington and New York in particular, I think we are running to use the GAO's expression in relationship to the report before you the probability of an unacceptable risk at some point as to congestion; speeds and the possibility for accident if we continue to try to develop freight service.

If we use the corridor as a principal passenger route and do not take into consideration the cost associated with freight on it what we will find is declining use of rail on the corridor itself and the probability that some of it will shift to truck which I do not think is the kind of policy you have in mind for the Northeast corridor.

Ms. MIKULSKI. I do not.

Mr. FLORIO. Will the gentlewoman yield?

Ms. MIKULSKI. Yes, Mr. Chairman.

Mr. FLORIO. You started talking about safety and certainly that is something everyone is concerned about but over what time-frame—it is my understanding and we have had people testify that in the foreseeable future there would be no operational difficulties with continuing to run freight and rail on the same car, that there is unused capacity that is there.

At what point appreciating the fact that you cannot be very precise, do we approach a safety problem by virtue of these two types of traffic?

Mr. JORDAN. Mr. Chairman, I saw the summary of a capacity study in which we participated with the Northeast Corridor Improvement Project Federal Railroad Administration which indicated if they reached the levels of service for the 100- to 120-mile-an-hour trains in the 1985-90 segment that there will be capacity constraints.

In the meantime there is a different dimension of that constraint which is clearly the same kind of financial question we talk about in deregulation. If the freight railroad is forced to absorb excessive maintenance costs in order to continue or capital expenditures for locomotives or signaling systems in order to preserve the safety elements associated with achieving those capacities then what we are in effect doing is increasing the cost out of relationship to the true value of the service as a freight service.

Mr. FLORIO. Would that dictate that marketplace forces then shift off of that?

Mr. JORDAN. Assuming we had a place to shift to.

Mr. FLORIO. Thank you. Ms. Mikulski?

Ms. MIKULSKI. Mr. Jordan, I only have one other question which goes to the continued reinforcement of the idea of the need for regulatory reform in order for Conrail to be viable.

Given in an order of priority what three regulatory reforms would you consider critical for the stability and growth of Conrail?

Mr. JORDAN. The first is the question of our individual freedom to move on joint rates. Today we are constrained by our partnership with other railroads who will have to concur in any change which we would make. Without that I think even the second is of marginal value but it certainly would be second and that is some degree of freedom at the maximum rate level to move without the protest and investigation of the present procedures.

It would allow us to more quickly follow the marketplace and to respond to shipper needs or carrier opportunities.

Third, I think if you get both of those in place what you would have is a carrier which is more closely approximate in the needs of his prospective shippers and present customers and then I think the third which would inevitably follow from that is some degree of increased speed or expedition in the proceedings associated with how we handle noncompensatory lines, urban and rural.

You will notice I carefully did not talk about abandonment because really it is not my view abandonment is a constructive way to proceed given what I said to you earlier with regard to the overall need for rail services as we look ahead in the next decade.

I cannot sit here and tell you if we practiced a massive abandonment that it would so materially improve our financial capacity even though we have analyzed it that we can make it that way and I think the country might be ill served by 7,000 or 8,000 miles of railroad disappearing from the Northeast.

Ms. MIKULSKI. Do you think we would be premature now in abandonment?

Mr. JORDAN. I most assuredly do. That does not mean there are not particular lines that are a problem. When you are talking about 10 or 20 miles you are talking about relatively small segments. I am talking about a big change.

Ms. MIKULSKI. Given what you said about the next couple of years being a little bit "ify" in terms of growth and transition and in terms of shifting to rail so that to abandon now would be a premature strategy and if we could hold on and not lose too much it might be a wiser method.

Mr. JORDAN. What I would suggest is the possibility of shifting the burden to protecting the community and the shipper rather than allegedly subsidizing the railroad for maintaining certain branch lines. If the expectation is as community needs a railroad for industrial development or for the prospect of sustaining its industrial development or economic development as presently in place, it is not inappropriate to subsidize that cost in some way with the railroad paying a trackage right for the use of it on the basis that it enjoys a reasonable return on it.

If there is a shift and railroads become more efficient the trackage right will inevitably start to pay off the original cost.

I am simply suggesting that we do not know enough about what is going to happen in the next decade about energy and transportation and we ought not make premature judgments and at the same time we ought to consider viability of the rail system itself and not make it a ward of the State while we wait to see what happens but attack the problems as we see them today.

Mr. FLORIO. Will the gentlewoman yield?

Ms. MIKULSKI. Yes, Mr. Chairman.

Mr. FLORIO. Certainly one of the motivations for rail deregulation is to have a better improved rail service, but I suspect that in the inner recesses of the administration there is someone who would admit also that it is designed to stop the flow of Federal funds into the rail system saying folks, you are going to make it on your own.

What you are suggesting, if I understand it correctly, is yes, there would be less Federal funds flowing to Conrail, or to rail systems who we now are going to provide funds flowing to other entities, because you would spin off those lines that you do not think are appropriate to put your valuable dollars into but give them to someone else and let them come to Congress for assistance whether it be branch line assistance or assistance to communities to maintain those lines.

That really does not diminish our financial responsibility. Is it not more appropriate that we make the decisions through some mechanism as to what it is that should be sustained and what it is that should not be sustained?

Mr. JORDAN. Mr. Chairman, if you can make that determination today based upon the knowledge you have then I completely concur with you.

My question is that we do not know enough about what kind of rail service we may need by the end of this decade and you may want to preserve those lines for some period of time.

There are many ways of preserving them and I think the evidence over the last 4 years support this and that would be far less expensive than the broad scale effort that is involved in preserving all of Conrail as an entity. For example the branch line program which we commenced with had about 3,000 miles in operation. My recollection is the subsidies were about $1 million a month and they have gone down from that period of time because they involve States and communities.

That is a relatively nominal number as compared to the $700 million of Federal money going into preserve Conrail as a totality.

I think there is clearly an opportunity in some cases to preserve those lines on a short line basis, that is turning them over to other operators. I would add I do not see any reason for the Government to turn them over on the basis that unfortunately enriches the recipient at the expense of the Government at the same time.

What we are talking about is the difference between how we operate those lines and whether or not there is another way of being efficient on those as compared to operating as we do as a large class 1 railroad.

Mr. FLORIO. Thank you.

Ms. MIKULSKI. Mr. Chairman, I have no further questions. Thank you very much.

Mr. FLORIO. Mr. Jordan, I have a few questions.

What is your thought about, and do you have any confidence in, the possibility of USRA being charged with the responsibility of coming forward with a restructuring plan very much the same way it was charged in the Amtrak restructuring plan? Do you think -t USRA is appropriately sensitive and that the results of whatever they came back with would be something that might be more appropriate than your present configuration?

Mr. JORDAN. You are asking me whether or not USRA ought to redo the final system plan?

Mr. FLORIO. Yes in a sense.

Mr. JORDAN. In the simplest way, clearly there is a problem of objectivity. I would acknowledge it before I answer. It is my view that the administration and Congress would be far better served by utilizing the resource of the corporation which I think understand the problem in considerable depth to make that determination as to what might happen.

I think in a matter of 3 months myself and two analysts sitting down with you and the appropriate chairman from the Senate and the administration could agree on what the requirements of the system would be; what we know about what has happened to date; what the prospects for different solutions are and reduce it to one or two prospective answers.

There is an enormous amount of analysis that has been done. Another final system exercise in my view would be redundant. It is not needed. We already know enough. We ought to be able to resolve the issue on the basis of where we are today.

Mr. FLORIO. As part of the proposal you are suggesting as an approach, would you contemplate opportunities for other rail systems to come into and serve a portion of the service area you are now servicing, or do you contemplate the result of the type of proposal you are talking about to be an exclusively Conrail controlled service area?

Mr. JORDAN. I have always testified I think under appropriate regulatory environment we would have to provide for further competition if that was a desirable answer to serve the needs of the communities and shippers in question if we could not or the reasons Mr. Lee asked about, if it has something to do with our inability to operate then the question we would have to ask ourselves and which I think would be quite apparent is increased competition to particular points a means of improving rail service for the region and/or is it a means of improving or degrading Conrail's prospects financially for succeeding?

You talk about competition to points where there are already three or four railroads who are dividing up the traffic. It is probably unlikely that more competition is going to enhance any one railroad's capacity.

When we go into a region where we are considered to be a monopoly what we need to examine there is another railroad going to enhance the value of service or is it going to decrease costs or is it going to divide up already unprofitable noncompensatory traffic. I think we can answer those questions.

Mr. FLORIO. Would you agree with the theory that if other improved service is available you would be more disciplined in improving your service and you would attract more traffic from alternative modes?

Mr. JORDAN. Mr. Chairman, if that were true we would not have had eight bankruptcies in the Northeast in the decade of the 1970's. There was plenty of rail competition throughout the Northeast. There were plenty of friendly connections to the small railroads and yet virtually half of the railroad industry was bankrupt in the Northeast.

There is a fundamental problem in the Northeast that we cannot ignore.

Mr. FLORIO. Other than title V moneys does Conrail anticipate coming to the Congress this year for extended authorizations?

Mr. JORDAN. No, sir, we do not intend to come this year. That is not to say that there may not be a need at some point in time. I have never stated that the $3.3 billion was a maximum number. First we must resolve the other questions.

Mr. FLORIO. The Southern and Conrail agreement on joint rates is something that is very important to our deliberations on deregulation. Can you give us your thoughts on that agreement, the apprehensions you may have in entering into such an agreement, and when in fact it relies to a large extent upon continuing agreements as to the connecting carrier's willingness to go along with your proposed increases? What makes you feel there is going to be those agreements in the future that would change your overall financial picture in a beneficial way?

Mr. JORDAN. You are very much aware that the initiative in these cases is now in the hands of the railroad who needs the additional revenue and the burden of proof has shifted to the other side. Unless there is a capacity to indicate that you are not entitled to that revenue you as the initiating railroad can increase your price.

That is a real turn from the way it has been where the mere veto of that initiative meant nothing would happen. We have cited before a number of incidents.

Mr. FLORIO. You have enough confidence in the objectivity of the accounting systems so that there will not be that many disputes as to whether you are meeting 110 percent of the variable costs as a result?

Mr. JORDAN. We have agreed to use the presently existing system, rail form A. It is not adequate in our view in terms of its precision on certain dimensions of costs and that is the specificity of certain moves.

Frankly, Mr. Chairman, the question before Conrail as it was before the rail industry and as before this Congress often is not what is perfectly right but what is acceptable that moves us forward from where we are. It is our view this moves us forward in a measurable way.

As I responded to Mr. Lee in combination with the other dimensions of regulatory reform in your bill we think the dollars we have estimated as required to assist us in getting out of this hole are present in that bill and therefore we support it.

Mr. FLORIO. Were Conrail to be totally out of the commuter business, would that enhance the financial picture for Conrail?

Mr. JORDAN. Yes, sir. I think so. We have shown in our annual report we are now owed some $90 million by passenger services after 4 years. It is a very significant sum.

Mr. FLORIO. What is the reason?

Mr. JORDAN. They are not paying us.

Mr. FLORIO. I assume they have some reason.

Mr. JORDAN. They do not have the money. If that seems a little facetious that is precisely what the problem is. In Philadelphia SEPTA does not have sufficient funds to make the payment. We have continued to debate the level of service and we are all and that is SEPTA; the State; the community and ourselves facing a very undesirable and unacceptable prospect of having to examine the question of discontinuing services under what we perceive to be the law.

Mr. FLORIO. It would not be something you would dig your heels in and fight about if in fact Amtrak were to negotiate with some of the commuter operating agencies for the purpose of assuming commuter responsibilities?

It has been conveyed to us they desire to do so.

Mr. JORDAN. I was not under the impression that the commuter authorities had conveyed that.

Mr. FLORIO. I am sorry. Amtrak has conveyed to us they are interested and willing to become involved in not only intercity traffic but also commuter traffic.

Mr. JORDAN. I think if Amtrak were to take over a principal dimension of the complexities that now exist which is the Amtrak commuter and Conrail operations over the corridor where we have three different parties involved, it would certainly be alleviated. You would have a bilateral as opposed to a trilateral.

We would not object providing we were properly protected in terms of past debts and our future use of those facilities.

Mr. FLORIO. Mr. Jordan, we thank you very much.

I am very pleased to call upon our very patient colleague from Connecticut, Congressman Dodd.

STATEMENT OF HON. CHRISTOPHER DODD, REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. DODD. Thank you, Mr. Chairman. I was delighted to be able to listen to the testimony of Mr. Jordan and to hear some of the questions from the members of the committee.

I thank you and the subcommittee for giving me an opportunity to be before you this morning to express some of the concerns that are felt very strongly by freight rail users in Connecticut and New England.

What you and your subcommittee do to deal with Conrail's continuing financial crisis will have a tremendous impact on business and industry in Connecticut and the other 16 States in which Conrail operates.

As cargoes, traffic volumes, type of service and availability of non-Conrail carriers vary from State to State in the Conrail region so also the options vary for addressing Conrail's financial problems and for insuring that shippers continue to receive rail service. Mr. Chairman, I think it is important to stop here and recall why we created the Conrail system and have authorized $3.3 billion in Federal funding for it since 1976. The reason was simple, as stated by Mr. Jordan and others who have been before this committee; it was to provide energy efficient and economically essential rail service to shippers in areas of the country where railroads were in bankruptcy.

Conrail was then and remains today nothing more than a vehicle for achieving that goal. However, if Conrail is found to be incapable of performing the task for which it was created either in whole or in part then alternative means of performing that task must be found.

At the same time I think all of us recognize the economic and political realities of these times. It is my feeling that continued Federal subsidizing of Conrail is not an option for dealing with its current or future problems. I say that not as someone who automatically opposes subsidies but I think we all recognize the tenor of the times we are living in and the demands being made on this institution for continued Federal support for a variety of programs.

I am merely stating more of a reality than my absolute opinion as to how I would vote on those matters.

Mr. Chairman, I would like to state for the record that I am not advocating the dismantling of the Conrail system. In many parts of its system Conrail has provided good efficient service, as it has for many rail users in my own state of Connecticut.

In many areas Conrail has done a truly impressive job of upgrading main lines and providing efficient long haul service. There is also a great deal of evidence that much of the local service rail operations in the State of Connecticut are unprofitable for Conrail.

For this reason, Mr. Chairman, I want to talk today about rail problems in an area of the Conrail region, my State of Connecticut, and how I believe service to shippers in the State can continue to be provided without additional Federal spending. I am introducing legislation today with Senator Pell from Rhode Island, who has a similar view of Conrail's operations in his own State. Our legislation mandates that the Secretary of Transportation develop a proposal for the transfer of all Conrail properties in Connecticut and Rhode Island to another railroad provided that the acquiring railroad meets a number of criteria, the most important of which would be agreement to operate service on the Conrail lines without Federal subsidy and without abandonment for at least 5 years.

Conrail's financial problems systemwide are well known and have been discussed in great detail already in this hearing. The simple fact is that Conrail is continuing to lose large sums of money and the GAO this morning has said that Conrail will need large Federal subsidies in future years whether or not rail deregulation is enacted.

It is Conrail's method of dealing with its financial crisis that threatens service to shippers in Connecticut. On page 8 of its report, GAO refers to the so-called August Plan developed by Conrail which calls for the abandonment of some 1,900 miles of its system as a way of reducing its operating losses. More recently in an article that appeared in the March 3 edition of Business Week the predication is made that Conrail, "will now have to move quickly to abandon 3,000 to 4,000 miles of track that Jordan, Conrail's president, calls 'marginal' even though the ICC moves slowly in abandonments." This latter estimate is essentially the same as the U.S. Railway Association identified in its report last Fall entitled "Alternatives to Conrail."

The USRA's analysis shows that the cutback in Conrail service would be especially severe in Connecticut where it estimates that

Conrail would have to "rationalize" which is a term I consider to be tantamount to "terminate," service on 45.1 percent of the track miles it operates in the State which is more than in any other State except Virginia.

Service would be rationalized on all but three Conrail operated lines in my State, Plainfield to Groton, Manchester to Hartford and Hartford to Waterbury. The USRA's analysis assumes that freight rail rate deregulation will pass the Congress this year and that the Federal Government will invest in Conrail an additional $850 million which is a commitment which I mentioned earlier that the Federal Government is highly unlikely to make in my judgment.

While Conrail has rejected the specific conclusions of the USRA's report. It has failed to identify what cutbacks would be needed. Conrail has said however that it is losing money in New England and the region's rail needs might best be served in the future by a core system of high density lines.

Conrail has repeatedly said that it is losing money on its boxcar operations. Fully 58 percent of the traffic volume in Connecticut is boxcar traffic.

In addition, information being gathered for the joint USRA-New England Regional Commission study of rail operations in the region shows that there has been a dramatic decline in the volume of rail freight traffic in the region between 1972 and 1977. Specifically the study has found a decline in traffic volume since the collapse of the old Penn Central.

Mr. John Sweeney, Conrail's vice president for government relations, recently spoke at a meeting on rail freight issues in Waterbury, Conn. and commented on Conrail's plans for Connecticut and New England. At that meeting which was sponsored by the Waterbury Chamber of Commerce and which I had the honor of moderating, Mr. Sweeney said that Conrail planned to continue providing service to shippers in the State and region, and that it would resist any effort to turn over to other carriers lines it now operates. While this statement sounded very reassuring Mr. Sweeney then went on to say that Conrail was not prepared to make any unequivocal commitments to continue providing service over its systems in the State and region.

This indefinite statement gives very little assurance that Conrail will continue to provide service in the State of Connecticut. As the USRA route rationalization shows, the unfortunate facts are that all but three of Conrail's lines in Connecticut would have to be rationalized even with additional Federal subsidies and deregulation. Conrail classifies all the lines it operates in the State as branch lines and it is branch lines that Conrail has repeatedly said are the most unprofitable parts of its system.

For these reasons I believe it is clear that regardless of what steps are taken to solve Conrail's financial problems, be it deregulation, abandonments or subsidies, service to shippers in my State is going to be threatened. As a result I believe the only alternative for my State is to transfer the lines.

The legislation I will introduce seeks to protect Connecticut and Rhode Island rail users from Conrail service cutbacks by mandating the transfer of all Conrail properties to other railroads after a thorough analysis has been performed. I would like to emphasize the various steps that would be required before we would allow any precipitous transfers. It is not just a shell and pea game.

The Secretary of Transportation would be required to develop a proposal for such a transfer. Any railroad that agrees to purchase all the properties, operate them without Federal subsidy, and maintain them for 5 years without abandonment would be eligible to bid.

If there is more than one railroad bidding for the lines as I hope there would be, the Secretary would select the bid on the basis of the railroad's ability to provide service to meet the transportation needs of the States of Rhode Island and Connecticut; to provide safe and efficient rail transportation on the Conrail properties and to be financially capable of acquiring the properties.

If no one railroad bids on all the properties the bill would then direct the Secretary to develop proposals for the sale of portions of the Conrail properties in Connecticut and Rhode Island. In this case the Secretary would also have to make the determination that the bidding railroad would be capable of providing service better than Conrail is.

Having identified an acceptable bidder the Secretary then would petition the special court for the transfer of the properties. The special court would have to find only that the transfer of the property is in the public interest in order for the transfer to be ordered. No railroad would be permitted to acquire Conrail lines for less than net liquidation value as of April 1976, the price that Conrail paid, adjusted by the GNP deflator index plus the value of capital improvements to the lines made since April 1976 and less depreciation since April 1976. In addition the acquiring railroad would have to agree to accept the same labor agreements that Conrail would be bound by under law.

Mr. Chairman, the procedure I am proposing is streamlined. It would make it possible for transfers of Conrail properties to occur before the Federal subsidy for Conrail runs out. In this way I hope that service to shippers will not be abandoned. At the same time it will allow Conrail to get rid of unprofitable lines.

There are railroads in the New England region which have already expressed a desire to acquire Conrail lines in the event they should be put up for sale. It is my hope that your subcommittee will include this proposal in the deregulation bill so that Government can help find a private enterprise solution to the rail problems of the States of Connecticut and Rhode Island.

If service abandonment is to be avoided the transfer process must be initiated soon. For this reason I hope that we will be able to work together to establish the process that is needed.

I thank the chairman and the committee for giving me an opportunity to come before you.

Let me take a couple of minutes, Mr. Chairman and emphasize that this bill that I am submitting today is a starting point. I am not wedded to specific language or wedded to the idea that other criteria might not be included or that some I have included may be unnecessary.

It seems to me we are confronted with some realities that we have to accept. We can delude ourselves into believing or not believing what is in front of us. I think the statements of Conrail, along with the studies that have been done and the assessments that have been made, indicate we are going to see a significant reduction in the kind of service we need. This service is necessary in order to maintain employment factors, and to insure the availability of transportation, both existing industries and for industries we would like to be able to attract to the Northeast region. Many of these industries are suffering because of the attractions of the Sunbelt area and for a variety of other reasons.

It seems to me that if we wait until the inevitable occurs we may find ourselves scrambling to put back something after it is too late.

The transfer proposal I have suggested is a way of hedging against the inevitable. That is the fundamental reason for the proposal. I have no desire to see us just switch heads in effect and be confronted with the same problems we are today.

Thank you for your patience.

Mr. FLORIO. Thank you very much.

I would like to call upon our very distinguished member of the subcommittee, Ms. Mikulski. I understand she has some constituents in the audience.

Ms. MIKULSKI. Thank you very much, Mr. Chairman. Today I would like to recognize the fact that my sister, brother-in-law and niece and nephew are visiting the Congress to see how both democracy and their Aunt Barb works. I hope they are as dazzled by democracy as I hope they are by me.

I would like to thank you for allowing me to recognize them.

I only have one question for the gentleman from Connecticut. Mr. Dodd, first of all I would like to compliment you on all of your work and leadership and bringing and keeping jobs in the Northeast area. Most of us in this Northeast corridor face many of the same problems and you have certainly been a leader in that.

I think your legislation is creative. I wonder if the private sector has indicated to you whether they would become involved in this; in other words are there some specific railroad lines and what indications have they given to you that they will work where Conrail has not?

Mr. DODD. There is at present one particular line that has expressed a strong desire to bid under a process such as the one I am proposing. It is the Providence and Worcester Line. There are others in the area that I think would be interested as well in bidding on at least a part if not all of the system, were it to become available.

The question of whether or not the Providence and Worcester or any other of these private lines are financially capable of assuming the responsibility under the criteria I have outlined is really a question that can only be determined by the people who would go over the books and look at the proposals as they are made.

There is unequivocally a strong interest by some very creative private carriers who are interested in proving that it is possible to provide good, efficient, reliable freight service without coming before the Congress of the United States to seek operating subsidies year after year.

Ms. MIKULSKI. Mr. Dodd, that is the point of my question, whether those private railroads have the financial capacity to provide service. What is it in their conversations with you that indicates they can make it?

Mr. DODD. I think they feel as though they are more aggressive in seeking new business and assisting industries that have special problems and helping them get over those hurdles so they can maintain them in business which is in their self interest as well. I think it is talking about an attitude in terms of trying to serve a constituency and particularly to try to serve a constituency where there is no guarantee that they are going to be helped financially by the public sector if they do not provide that kind of service.

Unfortunately, I think we have been confronted in the past with an attitude that it does not really make that much difference because it was always possible to come back to Washington and get help. These private carriers have not seen it that way and have proven they have been able to be successful, particularly the line I mentioned.

Ms. MIKULSKI. The reason I asked that is what you are saying is something similar to a conclusion I have reached. When it comes to really aggressive marketing, operations; and creative approaches to transportation as a whole, they are best left at the local or regional level where executives and planners know the region, establish personal relationships with the shippers, and become part of the solution because they want to attract more business into the community. What we need a national organization for is coordination and to make sure labor agreements are met.

The aggressive going after business and making railroads work and bringing in more business into your community and mine is best done by the people who have to live there and not some anonymous national organization that makes decisions by macroeconomic models and computer printouts.

Mr. DODD. That was the point I was making. I thank the gentlewoman.

Ms. MIKULSKI. Thank you. I would hope we consider what we are doing here. Maybe we need to think of a blend between the national organizational mechanism and aggressiveness, that dynamic quality found more at the local level. I do sense a local inertia; what the heck, if we make it we do and if we do not, we do not. It is not that activity that would make you and Ms. Grasso and the others happy.

Mr. DODD. The point is that these are short haul carriers. It is not something that spreads out forever. You want to make sure it is integrated, because you do not want to have a patchwork quilt. Particularly when you have a State like Connecticut, which is sort of the last link between Maine, New Hampshire, Vermont, Massachusetts and the rest of the country, you do not want to have a carrier that could in any way disrupt the availability of other links in that chain.

I say that because I think it is important that you do have that intense, creative, aggressive kind of attitude. But you also need a carrier that is reliable when the puzzle all fits together; you do not want to have a gaping hole which jeopardizes the overall delivery of freight by rail in the country.

Mr. FLORIO. I would like at this point to commend you for the imaginative proposal. It certainly is one of the options we will be utilizing as we go forward.

Let me just for the moment play the devil's advocate as to what Conrail might say in response to the proposal. Certainly an outside railroad would be able to come in as long as they can cherry pick their spots. They can certainly make the operation go. Conrail might say we could make an operation much better if we were not saddled with some unfortunate parts of the system; some terminal operations that are old and inefficient and very costly.

The probability is that they would not come in if they are required to assume labor obligations and assume a lot of things Conrail has that other railroads do not have.

Your concern about gaping holes left as a result of selective transfers dictates that someone look at the whole system to make sure that if one is going to parcel off provisions that they are all parceled off in conjunction with an appreciation of the need of the whole.

Particularly on the labor questions, do you have any thoughts as to how the railroads would address assuming the obligations that Conrail has concerning labor?

Mr. DODD. Let me take the first point with regard to the lines that appear to be unprofitable. It comes back, in a sense, to what Ms. Mikulski was saying. The question is whether or not some of those lines are unprofitable. They are unprofitable in some cases because there is not the kind of aggressive attitude in terms of making them work and attracting industry to locate along them, to do the kinds of things you need to do to make them viable. Thus, profitability can be self-fulfilling prophesy in some instances.

I think that is part of the problem. I do not mean to say that this is the whole answer. I do think it is part of it.

With regard to the labor agreements, again I would emphasize those that would have to be worked out. I realize there are some serious problems with labor agreements, but the rail lines that have expressed interest have said they feel they can live with agreements that are worked out as they have projected ahead their own ability to take over some of these lines.

I do not want to sit here and try to suggest that this is absolutely the case. It seems to me if a rail line is expressing that kind of interest, they are also suggesting they do not believe they would need to have the operating subsidies. We ought to be able to take a good look at that, and not just tell them no, you are wrong.

I am not going to say they are absolutely right, either. Maybe the labor agreements are such that anyone would have difficulty operating under them without some sort of Federal help.

It seems to me that if that is the case, then it is something the committee will have to look at. The point to be made is that we do have the kind of aggressive independent railroads that are interested in showing they can do this, do it well and efficiently, and provide quality service to shippers without having to come to the Government. Whatever can be worked out in that area will be worth looking at.

If it is not adopted systemwide in this manner, then certainly portions of it possible for this transfer plan to be may be carried out, particularly in areas where we may find Conrail has to pull back anyway because of its own financial necessities. Rather than waiting for that doomsday to occur, we should begin the process so we can have a relatively smooth transition. In this way we may avoid the economic dislocation that could occur as a result of a lapse of a year, at the minimum, between the abandonment and the possible picking up of that kind of line. We should keep in mind what such a lapse would mean to the industries affected.

Mr. FLORIO. Thank you. Mr. Lee?

Mr. LEE. Thank you, Mr. Chairman.

Congressman, as a neighbor from the West I would like to congratulate you on the recognition that we need to insure that we have a viable rail system for the Northeast, and I commend you for that.

On page 3 of your testimony explicitly under the process where you attempt to delineate how the Secretary would petition the special court for the so-called transfer and particularly your point you made that you are not wedded to this and this is still in a formative stage I would like to suggest a couple of points for your consideration.

It is my understanding the Federal court has not made a final determination as to the value of the Conrail system at this point and that is still very much before the court in being determined. You have difficulty in trying to isolate whatever a potential line may be in establishing what the value is.

It is my understanding the court has rejected the so-called net liquidation value procedure as being acceptable. What I am suggesting is in your staff work up in the Dodd-Pell bill you may want to look at the possibility of changing how you make that assessment under the transfer procedure.

As I see it it is not accepted by the court and there is no way to establish what that value may be.

Mr. DODD. I thank you for your suggestion.

Mr. FLORIO. Congressman, thank you very much.

Mr. DODD. Thank you very much, Mr. Chairman.

Mr. FLORIO. Our last witnesses comprise a panel consisting of Mr. Vance Taylor, president of the Chamber of Commerce, Northwest Connecticut; Mr. Robert Weltzien, chairman of the board and chief executive officer, Timex, Inc. and Mr. William Lazarek, deputy commissioner, Bureau of Planning and Research, Department of Transportation of the State of Connecticut.

We would appreciate your identifying yourself.

STATEMENTS OF ROBERT F. WELTZIEN, CHAIRMAN OF THE BOARD, TIMEX, CORP; VANCE A. TAYLOR, PRESIDENT, CHAMBER OF COMMERCE, NORTHWEST CONNECTICUT; AND WILLIAM LAZAREK, DEPUTY COMMISSIONER, BUREAU OF PLANNING AND RESEARCH, CONNECTICUT DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY RICHARD LEETE, DIRECTOR, RAIL PLANNING, STATE OF CONNECTICUT

Mr. WELTZIEN. Chairman Florio and members of the subcommittee, I am Robert F. Weltzien of Timex Corp. with corporate headquarters in Middlebury, Conn.

I am presenting testimony today in my capacity as vice chairman of State and Federal Affairs for the Greater Waterbury Chamber of Commerce representing the business community of western Connecticut and specifically the Naugatuck Valley, an area comprising a population of nearly 1 million people and a labor force exceeding one quarter of a million workers. The industrial sector includes the manufacture of primary metals; fabricated metals; electrical equipment; clocks; watches and related instruments; chemicals; rubber and plastic products. Rail freight service is a crucial transportation resource for the region which stretches from Long Island Sound to Massachusetts. Presently rail service is provided by Conrail on trackage that runs from Bridgeport up the Naugatuck Valley through the industrial centers of western Connecticut which includes Waterbury and north to Torrington.

Since the late 19th century, rail service has been a catalyst of economic development and served as the exclusive transportation resource that allowed Waterbury to become the brass capital of the world. Through the auspices of rail transportation our region at the turn of the century was also the center of the Nation's manufacturing source of clocks, watches, and rubber products. These industries flourished thousands of miles from the source of raw materials and the markets served. Interestingly the only real competition that ever existed in the region among rail carriers ended on July 1, 1898, when the New England Railroad became part of the old New Haven Railroad. Conrail today follows in this ignoble tradition of no competition and the history of rail service in the region reflects the economic consequences.

The current status of rail service is typified by an atmosphere of uncertainty. To quote an editorial which appeared in the Waterbury Republican—which is the region's leading newspaper—on March 19, 1980, "The Conrail operation is dominated by uncertainty, uncertainty whether lines will be retained, whether shipments will arrive on time, whether future subsidies will keep Conrail alive."

Rail users and most importantly potential rail users are discouraged in making long term capital investments without an assurance that the rail system will remain a viable transportation resource. Despite Conrail's assertions of a firm commitment for the future, recent experience and stark economic and public policy factors result in a questionable outlook for investors, which stymies economic growth. Federal subsidies have only forestalled inevitable policy decisions. Public subsidies have proportionately resulted in a poor return on leveraging private sector investments in rail dependent industries in our region.

Literally thousands of jobs in the region will be jeopardized by a crisis that daily seems more imminent in the context of Conrail's plight. Future opportunities in the region for industrial expansion are being deprived by the questionable future of Conrail.

On March 17 our chamber sponsored a conference in Waterbury to provide the business community with the facts, proposals, and pertinent information regarding the future of rail freight service in New England. Congressman Dodd and staff members of this committee were instrumental in providing the direction and scope for the meeting which included representatives of Federal and State government, Department of Transportation, Conrail, regional rail carriers, and the region's rail users.

Although a divergent range of opinion was expressed on the specific merits and demerits of current Conrail operations in our region, several points were clearly agreed upon.

The first point is that Conrail has indicated that its operations in New England are unprofitable. Announcements by Federal agencies indicate that Connecticut could again be placed in the crisis situation that existed between 1974 and 1976 during the restructuring of the Penn Central. As I have discussed, the demise of rail freight service in the region poses a grave economic threat.

The second point is that in order to continue viable operations, Conrail requires substantial additional increases in Federal subsidies reported at $782 million and that Congress is not willing to commit these Federal operating subsidies to the financially beleaguered railroad.

The mood in Congress toward fiscal restraint reflects the strong public sentiment in our area and in the Nation as a whole for limiting Government expenditures.

In response to the sentiments expressed at the conference, our chamber finalized a policy statement which calls on Congress to enact legislation to permit private rail carriers to purchase and operate Conrail lines. We strongly believe that private sector initiatives and reliance on our free market system should be encouraged and supported. Our main interest is in insuring that the rail service needs of our region are met; that a financially self-sustaining rail system is established, and that free competition is retained and encouraged.

We are particularly encouraged by a proposal mentioned by Congressman Dodd by the Providence and Worcester Company to assume operation of Conrail freight lines in Connecticut, Massachusetts, and Rhode Island. We are encouraged because this is the first time in our memory that a rail carrier has expressed an interest in our area and a commitment to the revitalization of our economy. Unfortunately our prior experience with Conrail and the Penn Central was not marked by an atmosphere of interest or commitment to the area.

It is clear that enabling legislation must now be formulated to provide a mechanism whereby regional rail carriers can assume the operation of Conrail lines within the framework of a free enterprise system.

We feel that this legislation by design should incorporate the goals outlined by you, Mr. Chairman, in a communication to the USRA.

Those goals are the maximization of competitive rail service in the Northeast; the minimization of loss of service in the Conrail region; the minimization of the need for Federal subsidy of rail service in the Northeast; and the requirement that carriers entering the Conrail region be required to acquire more than lucrative trackage and traffic.

Mr. Chairman, we strongly endorse these goals and suggest that the committee consider two additional requirements when formulating enabling legislation; carriers entering a region make a long-term commitment to the continuation of at least current service levels with no abandonments and that mandatory expeditious conveyance procedures of Conrail properties to other carriers be formulated and implemented as necessary.

You can see Congressman Dodd has many programs for implementing all of our proposals.

Mr. Chairman and members of the subcommittee, the rail freight problems confronting us in New England have been the subject of much controversy, much debate, much study, and much analysis. I respectfully suggest that the time to act is now upon us. We are all too well aware of the danger of delay for the economy of our region. We urge you and Government and we in the private sector dedicate ourselves to the task of restoring to New England and to the Naugatuck Valley the kind of quality rail freight service needed to assist the region's economic revitalization. Our future depends on it.

Thank you for this opportunity to address you.

Mr. FLORIO. Thank you very much.

Mr. Taylor?

STATEMENT OF VANCE A. TAYLOR

Mr. TAYLOR. Mr. Chairman and members of the subcommittee, I am Vance Taylor, president of the Chamber of Commerce of Northwest Connecticut, located in Torrington, Conn.

I appreciate the opportunity to appear here today to speak for the many businesses and industries of northwest Connecticut which depend on rail service for shipping and receiving of their goods. In fact three of these rail users, Charter Oak Container; Pfizer & Becton-Dickinson consider this issue of such importance they financed my trip here today. Two freight lines presently serve these users with 3-day-per-week schedules; the Torrington line, running north from Waterbury to Torrington and the Berkshire line running south from Pittsfield, Mass., to Canaan. Over the past several years both these lines have been troubled with the Torrington line placed in category II by Conrail and the Berkshire line railbanked south of Canaan to Danbury. We are particularly concerned about the Torrington line since Conrail has postponed possible abandonment proceedings pending the outcome of its long sought deregulation proposals.

Even with deregulation Conrail claims it would need an additional $144 million to operate through 1981 and without deregulation that figure would jump to $553 million. If sought through loans from the Federal Government either amount would represent additional moneys beyond the $3.3 billion previously authorized.

Conrail has further indicated that deregulation would significantly improve its financial picture, thereby reducing its long-term need for Federal aid. One primary problem, Conrail believes, is that certain kinds of business including general freight in boxcars which incidentally is the principal shipments on the Torrington line and indeed accounts for 58 percent of Connecticut's rail freight business contribute far less in revenues than they allegedly cost in capital outlays and in operations.

Many of our users would argue that the losses are not due to the inherent nature of the business but rather to Conrail's inefficient and unresponsive service. Conrail indicates deregulation would give them the freedom to abandon routes or raise rates to the point where they in their sole discretion either cover costs or drive business off the line. Our chamber's board of directors believe deregulation with these adverse economic impacts is not a viable alternative since deregulation could then become de facto abandonment.

We are frankly concerned that our problems with a regulated rail operator could worsen if deregulation occurs. Conrail, which operates both the Torrington and Berkshire lines, has generally maintained an indifferent attitude toward improving its service, increasing its level of traffic, or maintaining and upgrading its facility.

Several recent events will illustrate my points; first, a Conrail sales representative has not made a routine sales call on any of the lines users in over a year; second, Charter Oak Container, Torrington, the largest rail user sought Conrail's assistance in expanding track facilities adjacent to its plant to accept greater numbers of carloads.

Since Conrail only provides service three times per week and Charter Oak's current siding cannot accommodate unloading of more than three cars the firm was receiving significant demurrage charges for cars which could not physically be unloaded. Charter Oak therefore recently purchased a locomotive and track to perform much of its own switching and eliminate demurrage charges. Yet when Charter Oak sought Conrail's advice in designing the new siding to also be compatible with Conrail's equipment Conrail was unwilling to cooperate.

Further, Charter Oak has had a $280 surcharge levied on each carload of pulp board it receives but the firm sees no improvements in service for its added costs. If the theory of surcharges is to make the operator most profitable and provide better service, Charter Oak is not seeing the results.

Third, the Hotchkiss Bros. Co. in Torrington had five carloads of materials waiting in Waterbury on a day when the train normally did not run to Torrington. Although this number of cars represented a larger than average trainload, Conrail refused to make an exception to transport the goods until the following day. Faced with no materials for production, the Hotchkiss Bros. were forced to lay off its entire workforce of 90 employees for the day.

Fourth, the Pfizer Co. in Canaan ships clean sifted limestone outbound in covered hopper cars. Although the Berkshire line has been recently upgraded the improvements mean little to the company due to unavailability of these cars. Further, Conrail's car utilization requirements state that unless Pfizer's fleet of cars average at least one round trip per month cars are removed from the fleet. The cyclical nature of Pfizer's business coupled with the transit times, unloading operations at customers and delays Pfizer has experienced with Conrail, result in cars often taking longer than a month for a round trip. With the removal of hoppers from Pfizer's fleet and the general lack of availability of these cars, Pfizer often receives cars which previously contained other materials. To avoid contamination of its limestone, Pfizer must then manually scrub the interiors of all the cars which is a time-consuming and expensive procedure.

While Pfizer's shipments by all modes have doubled since 1976, the portion of shipments on rail has dropped 33 percent as the firm shifts to truck due to its greater reliability. Truck is more expensive but what can Pfizer do when a customer needs an order by a specified time and a Conrail hopper requires a 2 to 4 week delivery from the date requested?

Fifth, Becton-Dickinson in Canaan faces a similar situation. The firm receives resin in stainless steel closed hoppers but cars are either unavailable or in disrepair. The company now receives many of its shipments by truck, with four truckloads required to replace each rail car. Becton-Dickinson has also moved all of its outbound shipments to truck again due to lack of rail cars and lack of daily train service. Additionally, the firm would like to expand its Canaan facility but plans are inhibited by Conrail's unreliability.

Our chamber of commerce has also found problems in working with Conrail. Conrail had never conducted a marketing analysis of the Torrington line to determine ways to increase revenues and cut costs. Working with the Connecticut General Assembly our chamber was able to obtain $15,000 in State funds to conduct such a study for Conrail. Should not the railroad have been willing to help itself and our users? Second, since maintenance and improvements on the line have not been performed in years, portions of the line had fallen below class I standards with trains forced to travel under 5 miles per hour. Our chamber in cooperation with the Litchfield Hills Regional Planning Agency was successful in securing a $350,000 EDA grant to rehabilitate the line. When I informed Ronald Bowes, Conrail's assistant manager of strategic planning in Philadelphia of the likelihood of receiving the grant and asked what assistance we could expect from Conrail for improving their line he replied, "If you put money in that line you won't get a bang for your buck, you are lucky if you get a pop."

Mr. Chairman, we are aware of your view that Congress cannot sit back and take a wait and see attitude with regard to Conrail yet neither can our rail dependent industries. In fact our chamber's board of directors which represents over 350 businesses and industries in our area feels as you do that Conrail may not be the best final solution for the Northeast's and Connecticut's rail needs. Consequently they unanimously supported the Providence and Worcester's recent proposal to acquire Conrail lines in Connecticut and in so doing provide more effective and efficient rail service to our employers.

I fully concur with Congressman Dodd's and Mr. Weltzien's remarks that congressional action is needed in an expeditious manner to assure improved rail freight service and the continued revitalization of southern New England as a manufacturing region.

I appreciate this opportunity, Mr. Chairman, to appear before the subcommittee and trust you will respond favorably to my testimony. Thank you.

Mr. FLORIO. Thank you. Mr. Lazarek?

STATEMENT OF WILLIAM LAZAREK

Mr. LAZAREK. Mr. Chairman and members of the subcommittee, my name is William Lazarek. I am the deputy commissioner of the bureau of planning and research of the Connecticut Department of

Transportation. I thank you for the opportunity to appear before the subcommittee.

To my left is Dick Leete who is in charge of all the rail planning for the State of Connecticut.

We are very concerned in Connecticut about the future of Conrail. While the service provided by Conrail in some areas of Connecticut is generally good and has kept many of Connecticut's shippers and receivers relatively satisfied, indications from Washington based on what we have heard today on the further funding of Conrail and therefore improved service on Conrail has been mostly pessimistic.

We have heard this morning that it will cost hundreds of millions of additional dollars to allow Conrail to continue its present level of operations with very little improvement to the lines.

If these funds are not forthcoming Connecticut will find itself in a very vulnerable position. When Conrail exhausts its present authorizations probably in March of 1981 cutbacks in service, maintenance programs and the size of the system will probably be implemented. USRA, Conrail's banker and monitor in a September 1979 report entitled "Alternatives for Conrail" predicted that the best alternative course of action for Conrail would include a 4,600-mile rationalization or in other words, abandonment, plan. This plan if implemented would result in Connecticut losing about 50 percent of the trackage now served by Conrail.

As many of you know because of the concern in New England over Conrail's future the New England Regional Commission and the USRA are jointly sponsoring the New England rail restructuring study. Advisory boards including railroad management, shippers, State rail people and rail labor have been established to give advice and comment on that study.

The study by the way is considering three alternatives including one that very closely resembles the proposed amendment of Congressman Dodd.

Under normal conditions we would have preferred to review and analyze the data and results of that New England rail study before deciding on a course of action for Connecticut appropriate to Conrail's financial situation and the service. The preliminary results of that study are due this month with the final report due in June.

Since timing is so critical on this whole situation and because of what we have heard this morning, there were very strong indications that Congress is not going to authorize sufficient additional funds for Conrail to maintain existing levels of service, continue complete, full normalized maintenance, and reinstitute the rehabilitation of track previously subjected to deferred maintenance and if the USRA's "Alternatives for Conrail" is an accurate assessment of what would happen in Connecticut we feel we are in very deep trouble and we would fully support the proposed amendment.

I would like to add one other point for consideration as Congressman Dodd's proposal goes through and that is on the locomotives and the rolling stock, if a private railroad is going to come in and take over a certain area, if they are allowed to come in, it should also be considered and probably should be in the bidding procedure that they are also allowed to bid on the Conrail locomotives and rolling stock in order to make sure there is enough equipment to run on those lines.

Thank you very much.

Mr. FLORIO. Thank you.

Gentlemen, if in fact we are going to rely upon the marketplace forces to determine the allocation of revenues and the allocation of capital and if in fact we have roads that are class I in a state of disrepair and an absence of sufficient equipment to Conrail, I think we can expect that deregulation will inevitably result in the upward adjustment of costs so as to generate the revenues and the capital to deal with those things you indicated are deficient in the existing service capabilities of Conrail.

Is everyone prepared for the results of deregulation which is going to rely upon the marketplace forces so much?

Mr. WELTZIEN. Actually any efficient industry requires heavy capital investment and a productive result from that capital. One of the major long-term historical problems of the rail industry is the lack of investment in improved productivity.

We obviously cannot comment on the specific proposal from this one railroad but they have a reputation for being extremely production oriented, productivity oriented, and making a high return from their investments.

We would assume and again we cannot endorse their proposal at this moment but the assumption is the investments they make will be so productive that they will return a profit and at rates that may not be higher than the present rates.

Mr. FLORIO. Someone said that the actual value of some of the plants Conrail has is still in dispute and there is a question as to what that is. Likewise, you have heard discussion about the labor agreements that one would assume would have to go with the employees.

I think the proposal Mr. Dodd is talking about and the one you have talked about is something that is very deserving of examination and evaluation. I am hopeful we are going to examine any of these applications in the context of the whole system so as to provide for service across the whole area.

I know your particular interest is a localized area. I think we, as the Congress, have the responsibility to come up with \$3.3 billion as we have already, and will probably have to come up with a lot more when it comes time to settle the litigation that resulted in Conrail.

We have an obligation to make sure what it is that is going to happen for the benefit of the areas as well as the overall taxpaying public. We would not want to see segments being shuffled off and the taxpayer left as the loser. We cannot give all the good portions to private railroads with Conrail, or whatever we are going to call it, stuck with a system that is even less productive and even less profitable than it is now.

Mr. WELTZIEN. Mr. Chairman, I would like to make another comment to illustrate my point.

There are many cases of union workers being given productivity incentives. The specific case my colleague is very familiar with is the use of carloading as the efficient use of the cars which is a critical factor, about the roadbed obviously I would have no comment.

There are many possible advantages that could be made immediately by a local carrier in return on current investment.

Mr. FLORIO. I would ask if anyone would care to respond to the points Mr. Jordan made earlier when he said he has some question as to whether one railroad would have enough traffic to make its own way if another railroad were let into the marketing area and thinks that perhaps the financial attractiveness of either of them could not be enhanced. Are you contrarywise dividing up the inadequate amount of traffic in an overall declining area?

He made the statement he did not perceive a great amount of turnaround in the whole economic situation in the Northeast in the foreseeable future.

His conclusion was that if you have a restricting economic base and if you let more railroads in to serve that base, inevitably it will result in each of them being less profitable.

Mr. LAZAREK. I think one of the things we are most concerned about in Connecticut and I think it is as Representative Lee mentioned before, the cherry picker. He said you can go in and cherry pick certain lines. I think we are afraid of exactly the opposite thing happening in Connecticut. We are afraid of finding ourselves confronted with a situation where one branch line is being abandoned here and another one here and another one here. So you would not be in a situation having more than one railroad coming into an area.

You would be more in a situation of not having any railroad service in an area. This is why we feel it is at that point or that it is at a critical point right now where we have to take action. We are doing it through a study but having heard what we have this morning, we feel that we do have somebody that is willing to come in on our line and we keep getting back to one railroad in Connecticut and the Rhode Island area—we have a railroad that has indicated a willingness to go in and take any lines contiguous to the lines they run right now including some that Conrail has already indicated they feel are very unprofitable.

They have taken over a line and they are making profits today on a line that was also considered to be very unprofitable.

Mr. FLORIO. Part of the basic premise of the legislation we are developing in deregulation is that no railroad should be required to maintain a portion of its business at a loss. If one accepts that fact, is your State prepared to pick up branch lines that Conrail can demonstrate are losing money for them?

Mr. LAZAREK. If they are going to drop the branch lines, we would prefer to go with Congressman Dodd's proposal where these would be offered through bid for railroads to come in under the condition they would not be subsidized and they would maintain the operation.

Mr. FLORIO. It would be very critical of Conrail's productivity and their ability to run a good railroad. Why would we think anybody else would want to pick up admittedly losing branch lines?

Mr. LAZAREK. I guess there are different ways to run a railroad. This one railroad in Connecticut and in the New England area has demonstrated they can do it.

In Connecticut we are subsidizing for the branch lines right now. We have already indicated our willingness as well to go in there and work on the lines Conrail has said were unprofitable.

Mr. TAYLOR. Mr. Chairman, I think in many of the cases we have discovered with Conrail, it tends to be a self-fulfilling prophesy about their declining revenue base. As I indicated in my testimony, when an industry does not see or hear from a Conrail sales representative in over a year's period of time, you can begin to wonder why the railroad is losing money on some of these lines.

Certainly the railroad has not proven itself to be an aggressive company. It has not gone out and looked for business. It has not accommodated the needs of the shippers with the appropriate type of rolling stock.

It is quite obvious why there is declining revenues. We feel a private enterprise that indeed is going actively after business would in fact tend to generate greater revenues on the line.

I would also like to respond to the other point you mentioned about deregulation. Our fear is, in a sense Conrail now in many portions of the Northeast is indeed a monopoly. If that monopoly is deregulated we are very fearful, as our shippers are, that either rates will rise to such an extent that either the shippers will, if they are truly captive be forced out of business, or else have to relocate to another area served by another rail line that in fact is more productive and more competitive.

Mr. FLORIO. Even with the conditions of the marketplace?

Mr. TAYLOR. I do not know when we are talking about the economic strength of an area if we can literally cut one of its lifelines and throw it up to the market. We have a commitment to certain public policy as well as pure questions of economics.

Mr. FLORIO. That is the argument for regulation, that there are no marketplace forces that totally dominate it.

Mr. WELTZIEN. I think you made the point very well before that you can deregulate airlines because people can fly in and out of one airplane. Rail track is hard to deregulate.

We would like to see the branch lines competitive insofar as possible. That would be done through bidding for branch lines.

Mr. FLORIO. Is there much short line railroad activity in your area?

Mr. LEETE. In New England there are a number of short lines. In Connecticut I would not say there are any, they are more small regional carriers. We have two serving Connecticut, the Central Vermont and the Providence & Worcester. There is a very small 6-mile-long branch line in Branford, Conn., but that is about it.

I would like to make one comment relative to the net liquidation value situation that Congressman Lee mentioned earlier. Conrail paid net liquidation value for the property in 1976 and in the 3R act as amended and I think even in the original version a deficiency judgment provision was included which would require the United States to cover whatever differences there were that would determine in a court action.

I think Congressman Dodd's proposal which is an amended supplemental transaction procedure would be very consistent using a net liquidation value plus the deflator plus the value added et cetera. It would not be any different. It would be just a matter of continuing the restructuring process in the Northeast.

Mr. FLORIO. Do you not think that would be an inhibiting factor on a railroad that had an interest in acquiring a portion of the plant, yet they would acquire it at a particular price with the proviso that when the Federal Government is required to pay a higher price assuming the settlement value which I think we all do, it is going to be higher and there will be a need to recompensate the Federal Government for its proportional share that it has to pay out as a result of the litigation?

If I was in business I would not want to buy something without knowing what the final price would be. Unless you are advocating the alternative which is just pay what has been paid already and forget about the suit in which case we are talking about a very substantial indirect subsidy to the private railroad.

Mr. LEETE. I would propose something very similar to the later course and that is the Congress in the 3R act stated that if there were deficiency judgments coming out of the litigation that the United States would pay for that. We are talking about a continuing restructuring process.

Mr. FLORIO. The United States has paid for all of it. They paid for it initially and now will pay for the supplemental amount resulting from the litigation.

Mr. LEETE. The amount that is going to be paid will not be different under either of the situations whether Conrail remains in Connecticut because there will be a deficiency judgment on those lines or there will not be depending on the result of the litigation or if the private railroad takes over and pays Conrail the amount Conrail paid, cash instead of securities I presume, you would still have the same net amount that the Federal Government would have to pay the Penn Central and the other bankrupts.

There would not be a difference in this. There would be no change in the situation. The Congress or the United States would be liable for the same amount of money.

There would be some return in that if there was a lot of capital investment made by Conrail then there would be this value added, this GNP deflator and the compensation for the amount of capital money that was put into the plant itself. There would be some benefit and some return.

Mr. FLORIO. Gentlemen, thank you very much.

[Whereupon at 1:07 p.m. the subcommittee was adjourned.]

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